IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-910

GOVERNMENT OF THE VIRGIN ISLANDS and LEROY A. QUINN, Commissioner of Finance,

Petitioners,

v.

VITCO, INC.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit dated July 26, 1977.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 560 F.2d 180 and is printed in Appendix A, *infra*, p. 1a.

The opinion of the District Court of the Virgin Islands is unreported. The opinion of the District Court is printed in Appendix B, *infra*, p. 1b.

JURISDICTION

The judgment of the Court of Appeals was entered July 26, 1977. The jurisdiction of this Court is invoked under 28 USC §1254. A Motion for Permission to File Suggestion for Rehearing En Banc Out of Time was filed on August 17, 1977. The Order of the Court of Appeals denying Petitioners' Motion for Rehearing En Banc was entered September 14, 1977. On October 13, 1977, Petitioner filed an Application for Extension of Time within which to File a Petition for Certiorari. On October 14, 1977, Mr. Justice Brennan as Circuit Justice entered an Order Extending Time to File Petition for Certiorari to December 23, 1977.

QUESTIONS PRESENTED

1. Whether the mirror system of taxation, by which Congress has provided that the United States Internal Revenue Code is the tax code of the Virgin Islands with appropriate nomenclature changes substituting "Virgin Islands" as the taxing sovereign, is properly construed to require mirrored application of an Internal Revenue Service regulation favoring direction of taxes to the Virgin Islands, even where the Internal Revenue Service does not consider the regulation applicable to the Virgin Islands as a taxing sovereign.

2. Whether the mirror system of taxation is properly construed in accordance with the Court of Appeals' notions of "tax equality" and fairness to defeat the collection by the Virgin Islands of tax revenues which Congress plainly intends for the Virgin Islands to collect.

STATUTES AND REGULATIONS INVOLVED

The Statutes involved are Naval Service Appropriations act of 1922, as amended, 48 U.S.C. §1397 (1970) Revised Organic Act of the Virgin Islands 48 U.S.C. §1541 *et. seq.* (1970); Internal Revenue Code of 1954, §§881, 1441, 1442, 7701(a)(4) and (a)(5). See Appendix C, *infra.*

The Regulations involved are Treasury Regulations §§1.1441, and 1.1441-4(d). See Appendix C, *infra.*

STATEMENT OF THE CASE

This case involves questions of the proper operation of the "mirror" tax system which Congress has devised for the United States Virgin Islands. Succinctly stated, under this system the Virgin Islands applies the provisions of the Internal Revenue Code, substituting the words "Virgin Islands" for the words "United States," wherever they appear. Naval Service Appropriations Act of 1922, as amended, 48 U.S.C. §1397 (1970). H.R. Rep. 92-533, 92d Cong., 2d Sess. (Sept. 29, 1971); 1971 U.S. Code Cong. and Admin. News at 1863; S. Rep. 92-437, 92d Cong., 2d Sess. (Nov. 9, 1971); 1971 U.S. Code Cong. and Admin.

News at 1976; I.T. 2946, XIV-2 C.B. 109 (1935); Rev. Rul. 73-315, 1973-2 C.B. 225.

Respondent Vitco, Inc. (Vitco) is a Virgin Islands corporation and a wholly-owned subsidiary of Chase Instruments Corp. (Chase), a New York corporation. Shortly after its incorporation in 1958, Vitco, which then was in the business of manufacturing thermometers, received a ten-year grant of tax and fee exemptions and other subsidies from the Virgin Islands government, under a program designed to attract industry which would create jobs, stimulate the economy and ultimately increase tax revenues. Through that program the Virgin Islands government rebated to Vitco 90% of all excise taxes, 90% of all customs duties, 100% of all gross receipts taxes and 75% of all income taxes. The total benefit accorded to Vitco between 1958 and 1968 amounted to more than $268,000 and its retained earnings reached $513,251.82 in 1968.

By 1967, Vitco was deriving less than one-half of its income from manufacturing business. By 1970, Vitco's business consisted primarily of leasing machinery and equipment, and loaning money to its parent, Chase Instruments Corp., and other United States corporations. By 1970, Vitco had no employees in the Virgin Islands.

In 1970, 1971 and 1972, Vitco paid dividends of $25,000, $50,000 and $50,000, respectively, to Chase Instruments Corp.

Petitioner, the Commissioner of the Virgin Islands Department of Finance, issued a notice of deficiency asserting that under Sections 881, 1441 and 1442 of the Internal Revenue Code as mirrored Vitco should have

withheld and remitted to the Virgin Islands government 30% of the dividends paid in order to satisfy the 30% tax imposed on the United States (foreign) corporate payee.

Vitco filed an action for a redetermination of the tax deficiency in the United States District Court for the Virgin Islands. The District Court ruled that under the plain meaning of the relevant statutes Vitco should have withheld the tax. The United States Court of Appeals for the Third Circuit reversed, holding that it would be contrary to its judicial principle of "tax equality" to require Virgin Islands sources to withhold the 30% tax on dividend payments to United States taxpayers because the Internal Revenue Service has by regulation maximized the tax revenue flow to the Virgin Islands by exempting United States sources from withholding requirements on dividend payments to Virgin Islands taxpayers. While the Court of Appeals purported to limit its ruling to the issue of whether Vitco, Inc. may be required to withhold the tax imposed on Chase Instruments Corp., the effect of the Court of Appeals decision is to render collection of the tax from Chase Instruments Corp. impossible.

The Virgin Islands has collected from taxpayers identically situated with Respondent Vitco, Inc. some $18,000,000 to $20,000,000 of the withholding tax which is at issue in this litigation. If the decision of the Court of Appeals is not reversed, the Virgin Islands will be subject to refund claims for that amount. The withholding tax presently generates from $4,000,000 and $6,000,000 per year in revenues to the Virgin Islands.

REASONS FOR GRANTING THE WRIT

The Court of Appeals improperly substituted its judgment of the equitableness of the tax here in issue for that of the Congress. The Court of Appeals decision denies to the Virgin Islands a very substantial percentage of its revenues and will have an enormous adverse impact upon the fiscal stability of the Government of the Virgin Islands.

1. The judgment of the Court of Appeals, if allowed to stand, will have a disastrous effect on the level of government services provided to the citizens of the Virgin Islands.

The Government of the United States Virgin Islands provides services to its citizens from a revenue base which is largely defined and limited by taxing provisions enacted by the United States Congress. Congress has by 48 U.S.C. §§1574, 1574a and 1574b prohibited any deficit spending by the Virgin Islands Government.

The current operating budget of the Virgin Islands is approximately $137,000,000. Because of the limited revenue base, the budget has of necessity remained at virtually the same level since fiscal year 1975, despite rising inflation. The Governor of the Virgin Islands, in transmitting the current budget to the Virgin Islands Legislature, stated that it "support[s] only a minimally acceptable level of services," but that this was compelled by "a restrained and realistic allocation of limited resources." Budget Message of the Governor of the United States Virgin Islands, June 16, 1977, at 2, 7.

Approximately eighty percent (80%) of the operating budget is allocated toward the provision of social services, primarily in the areas of education (30%), health (14.5%), social welfare (5.3%), and public safety (9.5%).

The revenue loss due to the Court of Appeals decision in this case, in this fiscal year alone, in refunds and uncollected revenue, will approach $25,000,000, or between 15% and 20% of the operating budget.

The strategic importance of this diversion uncountenanced by Congress is as set forth in Appendix F, *infra*.

It is inevitable that such a revenue loss would dictate drastic reductions in governmental services, particularly in the above-mentioned areas of education, health, welfare and police and fire protection. In addition, substantial layoffs of government employees would occur in an economy already heavily impacted by unemployment. The judgment of the Court of Appeals therefore unquestionably threatens the fiscal stability of the Government of the Virgin Islands.

2. The judgment of the Court of Appeals, based on its own judicial notions of "the desirability of tax equality" between the United States and the Virgin Islands as taxing sovereigns, is manifestly contrary to the intent of Congress.

Congress means for the Virgin Islands to have the tax revenue which is at issue in this litigation.

The Naval Appropriations Act of 1922, as amended, 48 U.S.C. §1397 (1970), established the separate "mirror" taxing structure for the Virgin Islands by providing that the Virgin Islands should apply the income tax laws in force in the United States and receive the proceeds into its treasuries. The legislative history reveals that the purpose of this measure was to

make the Virgin Islands government financially self-sufficient, thereby avoiding the need for Congress to make special appropriations for its support. 61 Cong. Rec. 1725 (1921).

Section 881 of the Internal Revenue Code imposes a tax of thirty percent (30%) on so-called passive income (embracing interest, rents and dividends) received by "foreign" corporations from sources within the United States. Section 1442 of the Code requires that the domestic source or payor of the income must withhold 30% of the interest, rent or dividend in order to satisfy the Section 881 tax.

By the definitions of "foreign" and "domestic" contained in I.R.C. Sections 7701(a)(4) and (a)(5), a corporation chartered in a United States possession such as the Virgin Islands is a foreign corporation as to the United States, and a United States corporation is a foreign corporation as to the Virgin Islands. Rev. Rul. 56-616, 1956-2 C.B. 589. Dividends paid by a Virgin Islands corporation to its United States parent are therefore clearly subject to Sections 881 and 1442, as those provisions are applicable in the Virgin Islands.

a. The Court of Appeals sacrificed the plain meaning of the relevant statutes.

The Court of Appeals recognized (App. A, p. 9a) that the plain meaning of these provisions commanded withholding of the 30% tax by Vitco on its payments to Chase. Nevertheless, the Court of Appeals, relying on dicta to its decision in *Chicago Bridge and Iron Co. v. Wheatley*, 430 F.2d 973 (3d Cir. 1970), *cert. denied*,

401 U.S. 910 (1971),[1] erroneously held (App. A, p. 12a) that the mirror tax system is governed by an "equality principle" under which the Virgin Islands may not collect more tax than the United States would collect on the same income in the absence of the mirror system. The Court of Appeals ruled that because an Internal Revenue Service regulation, Reg. §1.1441-4(d), exempts United States payors from withholding on dividend payments to Virgin Islands taxpayers, there can be no withholding requirement in the opposite direction. (App. A, p. 10a). The sum and substance of the Court of Appeals decision is that Court's view that Congress' unequivocally expressed tax policy is unfair to American corporations with subsidiaries in the Virgin Islands.

Reg. §1.1441-4(d) was promulgated in 1956 to implement the Congressional design in the Revised Organic Act of the Virgin Islands, 48 U.S.C. §1541 *et seq.*, passed in 1954. Section 28(a) of that Act, 48 U.S.C. §1642, provides that permanent residents of the

[1] There, the Third Circuit decided that the Virgin Islands could not deny to a United States corporation the "Western Hemisphere trade corporation" deduction which would be available to it under I.R.C. §922 on a United States tax return. The decision was clearly inconsistent with the plain meaning of I.R.C. §§922 and 7701(a), as mirrored. Shortly after the decision, Congress eliminated the Western Hemisphere trade corporation deduction for purposes of application of the Internal Revenue Code in the Virgin Islands, in order to prevent a substantial loss of revenues by the Virgin Islands. Revenue Act of 1971, §307, I.R.C. §921. H. R. Rep. 92-533, 92d Cong., 1st Sess. (1971); 1971 U.S. Code Cong. and Admin. News at 1863-64; S. Rep. 92-437, 92d Cong., 1st Sess. (1971); 1971 U.S. Code Cong. and Admin. News at 1976-77.

Virgin Islands, including Virgin Islands domestic corporations, have no tax liability to the United States on any United States source income they might have; it directs that they pay tax on all their world-wide income to the Virgin Islands. The purpose of that section was to give the Virgin Islands greater economic autonomy and self-sufficiency by allocating to it revenues which had prior to that time gone into the United States Treasury. H.R. Rep. No. 1603, 83d Cong., 2d Sess. 13 (1954). The Court of Appeals' notion of a reciprocal exemption to United States recipients of Virgin Islands source passive income is clearly and completely antithetical to Congress' intent in that legislation.

Reg. § 1.1441-4(d) merely states a common-sense rule that the payor of the dividends should not be required to withhold where the payee has no liability for the 30% tax under I.R.C. §881. The regulation has no proper application here, where the payee Chase Instruments Corp., is indisputably liable for the tax under the plain meaning of the statute. The Internal Revenue Service has twice advised that Reg. § 1.1441-4(d) does not preclude the Virgin Islands from requiring withholding on dividends paid by Virgin Islands payors to United States payees. (App. D, App. E)

b. Congress has specifically declined to eliminate the favorable taxing powers the Court of Appeals thought so inequitable.

In *Sayre and Company v. Riddell*, 395 F.2d 407 (9th Cir. 1968), the Court of Appeals for the Ninth Circuit dealt with the identical claim raised by Vitco in this

litigation, in the analogous context of the "mirror" tax structure which Congress had also provided for Guam. The Ninth Circuit there concluded that since a United States corporation was a foreign corporation as to Guam, the plain meaning of Sections 881 and 1442 dictated that a Guam sole proprietorship had to withhold the 30% tax on interest and commission payments it made to a corporation chartered in Hawaii. In rejecting the taxpayer's argument that this result was so unfair as to discourage American investment in Guam, the Ninth Circuit stated:

> "We may not adopt a construction inconsistent with [the plain meaning of the statute] . . ., simply because we consider the result more equitable. Deviations from the intended dual structure by substantive revision of the basic scheme of the Code as applied to Guam must be left to Congress." 395 F.2d at 412-13.

In 1972, Congress did determine that the enforcement by Guam of Sections 881 and 1442 was bad tax policy, because it . . . "had the effect of seriously retarding investment by U.S. corporations in Guam." H.R. Rep. 92-1479, 92d Cong., 2d Sess. 3 (1972); 1972 U.S. Code Cong. and Admin. News 5402-5403. Congress therefore added new language in Sections 881 and 1442 to provide specifically that Guam should not collect the tax. 26 U.S.C. § §881(b), 1442(c); Pub. L. 92-606, October 31, 1972.

The Court of Appeals in the instant case divined from Pub. L. 92-606 a Congressional adoption of its across-the-board "equality principle" under which the Virgin Islands may not collect more tax than the United States collects on the same income. (App. A, pp. 11a-12a). To the contrary, Pub. L. 92-606 shows that

Congress will act to correct whatever tax disparities in the operation of the mirror system *it* thinks should be changed.

If Congress had meant to bar the Virgin Islands as well as Guam, from enforcing Sections 881 and 1442, it would have so provided in Pub. L. 92-606 – "expresio unius est exclusio alterius." Congress obviously was not as concerned about any disincentive or unfairness to American investors in the Virgin Islands, as it was with respect to Guam. Congress is well aware of the enormous subsidies provided by the Virgin Islands to American investors. Indeed, Congress has acted to limit those subsidies. 26 U.S.C. §§934(a) and (b); Pub. L. 86-779, §4(a), Sept. 14, 1960. There was no record of similarly extensive subsidies paid by Guam. *See* H.R. Rep. 92-1479, 92d Cong., 2d Sess. (1972); 1972 Code Cong. and Admin. News at 5401.

In its desire to superimpose its "equality principle" on the mirror system of taxation, the Court of Appeals grossly misinterpreted Public Law 92-606. Congress certainly does not believe that that law (or any prior enactment) removed the Virgin Islands' authority to enforce Sections 881 or 1442. In fact, in its consideration of Section 1041 of H.R. 10612, the Tax Reform Act of 1975, which would have repealed the United States' authority to levy the 30% tax on United States-source interest and dividend income earned by foreign corporate investors, Congress provided that the Virgin Islands could still continue to collect the tax. 121 Cong. Rec. H. 11780 (daily ed. Dec. 4, 1975). The repealer provision was amended out of the bill because it would have cost the United States $165,000,000 per year in tax revenues, a proportionately smaller amount

that the Virgin Islands stands to lose under the decision of the Court of Appeals. 121 Cong. Rec. H. 11843-45 (daily ed. Dec. 4, 1975).

As this Court has recently emphasized, where Congress' allocation of tax revenues is clearly stated, the Circuit Courts of Appeals are not free to scrap this clear expression in the false pursuit of their notions of "tax equity." *Commissioner of Internal Revenue v. Kowalski,* ____ U.S. ____, 46 U.S.L.W. 4015, 4021 (Nov. 21, 1977).

CONCLUSION

The Court of Appeals decision will have the most dire effect upon the fiscal stability of the Government of the Virgin Islands, and upon its ability to provide services to its citizens. That decision deprives the Virgin Islands of millions of dollars of annual revenues which Congress undeniably meant the Virgin Islands to receive. A writ of certiorari should issue to the United States Court of Appeals for the Third Circuit.

Respectfully submitted,

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APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 77-1065

VITCO, INC.,

Appellant

v.

GOVERNMENT OF THE VIRGIN ISLANDS and REUBEN B. WHEATLEY, Commissioner of Finance,

ON APPEAL FROM THE DISTRICT COURT OF THE VIRGIN ISLANDS DIVISION OF ST. THOMAS AND ST. JOHN (D.C. Civil No. 74-628)

Argued April 27, 1977
Before: VAN DUSEN, WEIS and GARTH,
Circuit Judges.

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OPINION OF THE COURT
(Filed JULY 26, 1977)

WEIS, *Circuit Judge.*

One may argue that the mirror system of taxation is not always the fairest of them all, but it does reflect the congressional intent to implement some degree of uniformity. In this appeal, we conclude that not only must statutory language be transposed but so must authorized implementing regulations as well. Accordingly, we hold that a Virgin Islands corporation must pay its tax obligations on all of its income to the Virgin Islands despite minimal contacts there. In addition, the withholding provisions relating to dividends paid to a mainland corporation do not apply since a similar provision in the United States Code does not cover income paid to a Virgin Islands corporation by a United States corporation.

Appellant Vitco is a corporation chartered in the Virgin Islands and is a wholly owned subsidiary of Chase Instruments Corporation, a New York corporation. Vitco's business consists primarily of leasing machinery and equipment, some of which was located in the Virgin Islands and some in the continental United States during the 1970-1972 period. Most of the company's revenues were attributable to the equipment located in the continental United States, and it was there that Vitco physically received its machinery rental and interest income from all sources. Having neither an office nor any employees in the Virgin Islands, Vitco maintained its place of business in Lindenhurst, New Jersey, in the same city as its parent. On its tax returns, however, Vitco lists its address as "P.O. Box 2488, St. Thomas, Virgin Islands."

For the years 1970, 1971 and 1972, Vitco submitted corporate tax returns and paid the amounts due to the United States government. The company also filed income tax returns with the Commissioner of Finance of the Virgin Islands for the same years, claiming as foreign tax credits the amounts paid to the United States.

The respondent Commissioner of Finance issued a deficiency notice, asserting that Vitco's taxes should have been paid to the Virgin Islands rather than the United States. Further, the Commissioner sought an additional amount allegedly due the Virgin Islands – a 30% "withholding" tax on the gross dividends paid by Vitco to its parent, Chase Instruments Corporation. The Virgin Islands based this latter assessment upon §1442 of the Internal Revenue Code, 26 U.S.C. §1442, which provides for the withholding of a 30% tax upon what

might be termed "passive" income paid to a foreign corporation. Since Chase is a United States Corporation, it is considered as "foreign" for Virgin Islands tax purposes.

The district court, agreeing with the Commissioner, determined that Vitco was required to pay taxes on its entire income to the Virgin Islands, rather than to the United States, and to withhold taxes due on the dividends payable to Chase.

As we have explained in the earlier cases, Congress neither passed a separate income tax law for the Virgin Islands nor permitted its legislature to do so. Instead, Congress provided that the provisions of United States income tax law should be used in the tax code of the Virgin Islands with necessary nomenclature changes to make them effective, that is, "Virgin Islands" should be substituted for "United States" whenever appropriate. The United States and the Virgin Islands are two separate and distinct taxing authorities, and the revenue due the Virgin Islands is paid into its treasury. This resulted in what has been called the "mirror system" of taxation. For a history and general description of its operation, *see Dudley v. Commissioner*, 3 V.I. 685, 258 F.2d 182 (3d Cir. 1958); *Chicago Bridge and Iron Co. v. Wheatley*, 7 V.I. 555, 430 F.2d 973 (3d Cir. 1970), *cert. denied*, 401 U.S. 910 (1971); and *Great Cruz Bay, Inc., St. John, Virgin Islands v. Wheatley*, 11 V.I. 189, 495 F.2d 301 (3d Cir. 1974).

As a matter of policy, Congress determined that the Virgin Islands should collect the tax on all income of Virgin Islands residents, including any received from sources in the United States. 1954 Revised Organic Act of the Virgin Islands, §28(a), 48 U.S.C. §1642. The statute provides:

> "... the term 'inhabitants of the Virgin Islands' as used in this section shall include all persons whose permanent residence is in the Virgin Islands, and such persons shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands...."

"Inhabitants" includes corporations as well as natural persons, *Chicago Bridge and Iron Co. v. Wheatley, supra.*

The legislative history of the Act is illuminating. The Senate draft of the bill stated that:

> "United States *citizens* residing in the Virgin Islands *may* satisfy their United States income tax obligations by paying their tax to the Virgin Islands, regardless of the source of their income." [emphasis added][1]

In a letter to the Senate Committee, the Assistant Secretary of the Interior said:

> "The Department bill, like the present organic act, provides that proceeds of customs duties, United States income taxes, any taxes levied by Congress on *inhabitants* of the Virgin Islands, and the proceeds of certain fees shall be covered into the Virgin Islands treasury. In addition, the Department bill would provide for the return to the Virgin Islands treasury of proceeds of United States internal-revenue taxes collected on articles produced in the Virgin Islands and transported to the United States. The chamber of commerce bill contains the same provisions, but in addition, it

[1] U.S. Code Cong. & Admin. News, p. 2595 (1954).

would also provide that the proceeds of any local income tax enacted in lieu of the United States income tax shall be covered into the Territorial treasury, and that a resident of the Virgin Islands may satisfy his income-tax obligation under applicable tax laws of the United States by paying his tax on income derived from all sources, both within and outside the Virgin Islands, into the treasury of the Virgin Islands."[2] [emphasis added]

When the bill went to a Conference Committee, certain significant changes were made:

"This section further provides that all persons whose permanent residence is in the Virgin Islands *shall* satisfy their United States income-tax obligations by paying their tax to the Virgin Islands regardless of their source of income. The conferees agreed to accept the wording of the House version that the term 'inhabitants of the Virgin Islands' shall include all persons whose permanent residence is in the Virgin Islands, in lieu of the Senate stipulation that 'inhabitants of the Virgin Islands' shall include all citizens of the United States whose permanent residence is in the United States."[3] [emphasis added]

Thus, the Senate agreed that the 1954 Act should apply to "persons" as opposed to "citizens," and that they "shall" pay the taxes to the Virgin Islands, rather than "may."

The first issue presented for review is whether the appellant, not having employees, bank accounts, or an office in the Virgin Islands, but being chartered and maintaining a post office address there, is included as

[2] Id. 2597, 2600.

[3] Id. 2625.

"a permanent resident" within the phrase, "inhabitant of the Virgin Islands." We conclude that for tax purposes it is.

It is important to realize that we are concerned, not with concepts of jurisdiction to adjudicate, forum non conveniens, venue, or service of process, but rather with the power to tax. Precedents bearing on other areas of the law are not necessarily controlling, particularly in this situation where Congress has authority to tax both United States and Virgin Islands corporations.

A basic premise is that the state of incorporation does have the power to tax the income of a corporation chartered by it, even if the company owns no property within the state, so long as interstate or foreign commerce is not hampered. No such limitations are asserted here. 14 W. FLETCHER, CYCLOPEDIA CORPORATIONS §§6887, 6970.1 (1975); 2 T. COOLEY, TAXATION §456 (4th ed.); *cf. Cream of Wheat Co. v. Grand Forks*, 253 U.S. 325 (1920); *Shaffer v. Carter*, 252 U.S. 37 (1920); *U.S. Glue Co. v. Oak Creek*, 247 U.S. 321 (1918). Definitions in the Internal Revenue Code are also instructive. 26 U.S.C. §7701 categorizes corporations as "domestic and foreign."

"(4) Domestic – The term 'domestic' when applied to a corporation . . . means created or organized in the United States or under the law of the United States or of any state. . . .

"(5) Foreign – The term 'foreign' when applied to a corporation . . . means a corporation . . . which is not domestic."

Treasury Regulation 26 C.F.R. §301.7701-5 states in part:

"A domestic corporation is a resident corporation even though it does no business and owns no property in the United States."

Further support is found in §11(a) of the Code, 26 U.S.C. §11(a) and Treas. Reg. §1.11-1(a):

"It is immaterial that a domestic corporation . . . may derive no income from sources within the United States."

In *Chicago Bridge and Iron Co. v. Wheatley, supra*, we held that Virgin Islands corporations are not United States domestic corporations but are considered foreign corporations for purposes of the Internal Revenue Code. *See also* Rev. Rul. 56-616, 1956-2 CUM. BULL. 589. Using the mirror technique, therefore, we may transpose the language in the statute and treasury regulations to provide that a corporation chartered in the Virgin Islands is a domestic corporation as to that jurisdiction even though it does no business and owns no property in the Islands.

The Internal Revenue Code demonstrates an intention to tax a corporation which has been chartered by the United States/Virgin Islands despite the fact that it does no business and owns no property in the United States/Virgin Islands. Consistent with this statutory intent, therefore, §28(a) of the Revised Organic Act must be interpreted to include as a "permanent resident" and therefore an "inhabitant," a corporation chartered by the Virgin Islands and to subject its income from all sources to tax by the Virgin Islands. We conclude, therefore, that Vitco is liable to pay tax on all of its income to the Virgin Islands.[4]

[4] In light of our conclusion, we need not consider the applicability of 26 U.S.C. §906 (foreign tax credit) since under §28(a) of the Revised Organic Act, Vitco's tax liability is to the Virgin Islands, not the United States. *See* Dudley v. Commissioner, *supra*; Great Cruz Bay, Inc. v. Wheatley, *supra*.

The second issue confronting us is whether Vitco should have withheld the 30% tax on the dividends payable to Chase. In this connection, we must give some consideration to Chase's status since the claim is that its dividend income is subject to the tax under §881, although Vitco has the duty to withhold under §1442.

26 U.S.C. §1442 provides for withholding of a 30% tax on the gross amount of specified income received by foreign corporations from sources within the United States. The income affected includes interest and dividends, among other forms.[5] Using the mirror technique, the statute, standing alone, would appear to authorize the Virgin Islands to require Vitco, a Virgin Islands source, to withhold 30% of the dividends payable to Chase, a foreign corporation. However, Treas. Reg. §1.1441-4(d) makes special provision for inhabitants of the Virgin Islands. It reads:

"*Inhabitants of Virgin Islands* –

(1) *Allowance of exemption. No withholding is required under §1.1441-1 upon any item of income paid to any person who* at the time of payment reasonably *expects to satisfy his income tax obligations* with respect to that item *under §28(a) of the Revised Organic Act* of the Virgin Islands (48 U.S.C. §1642). That section provides

[5] Section 1442 refers to the type of income listed in Section 1441(b) which reads as follows:

"(b) Income items. – The items of income referred to in subsection (a) are interest, dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income. . . ."

> that all persons whose permanent residence is in the Virgin Islands 'shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the Treasury of the Virgin Islands.' For the purpose of this paragraph the term 'person' shall include an individual, partnership, and corporation."[6] (emphasis supplied)

Thus, while the statute facially would allow the 30% tax on dividends received by a Virgin Islands corporation from United States sources to be withheld, the regulation provides a special exemption which negates the apparent effect of the statute. Ordinarily, regulations may not have this effect, but in this instance the regulation is in harmony with the congressional intent underlying the Revised Organic Act of the Virgin Islands – an Act which is effective as if it had been enacted subsequent to the Internal Revenue Code, 26 U.S.C. §7651. We hold, therefore, that the regulation is a valid application of the statute and, thus, there is no withholding on dividends paid by a United States domestic corporation to a Virgin Islands (foreign) corporation. Therefore, if the regulation as well as the underlying statute is mirrored, there can be no withholding on dividend income paid by a Virgin Islands corporation to a United States (foreign) corporation.

The Commissioner contends that (1) the mirroring technique does not provide for a two-way substitution,

[6] Although this regulation was promulgated under 26 U.S.C. §1441, it also applies to withholding under 26 U.S.C. §1442. *See* 26 C.F.R. §§1.1442-1, 1.1441-1.

i.e.; "Virgin Islands" may be substituted for "United States," but not *vice versa*, and (2) the result would be contrary to congressional intention. We are unable to accept either argument. The treasury regulation modifying the thrust of the statute must be mirrored as well as the statute itself; otherwise, there would not be a true reflection. Moreover, the Commissioner's "one-way" mirroring technique is simply contrary to Congress' understanding of this technique. An illustration is provided by legislation enacted for Guam. Though far removed geographically, Guam encountered a problem quite close to the one at hand, and the resolution is instructive.

In *Sayre and Company v. Riddell*, 395 F.2d 407 (9th Cir. 1968), the Court of Appeals for the Ninth Circuit determined that under §881 as mirrored, Guam could impose the 30% tax on interest received by a Hawaiian corporation (considered a United States corporation for this tax purpose) from a Guam sole proprietorship. Although under this construction the United States corporation could, in some circumstances, pay a greater tax on the interest than if the same amount had been derived from a United States source, the court noted that Congress could readily provide relief appropriate to Guam without distorting the basic tax structure.

Congress accepted the suggestion and, in 1972, amended the Internal Revenue Code to prevent Guam from taxing a United States corporation's "passive" income or withholding such tax. It accomplished this result not by amending the Organic Act of Guam, but by amending the United States Internal Revenue Code, §§881 and 1442. Congress added to them a provision that Guamanian corporations were not to be treated as

foreign corporations. By application of the mirror system, United States corporations would be treated as domestic corporations by Guam and, hence, would not be liable for the tax. The congressional reason for the amendment was set out in the legislative history:

> "Since no deductions are allowed, the tax on this income, in many cases, is higher than the regular comporate [sic] tax would be if deductions were allowed. . . . The fact that this income now is usually taxes at a higher rate than similar income earned in the United States has had the effect of seriously retarding investments by U.S. corporations in Guam." 1972 U.S. Code Cong. & Adm. News 5402-5403.

Concluding that disparate tax treatment by Guam was undesirable, Congress changed the policy by inserting language in the United States tax law knowing that the mirror effect would change Guamanian law. Obviously, Congress intended a "two-way" mirroring.

This court recognized the desirability of tax equality in *Chicago Bridge and Iron Co. v. Wheatley, supra.* In discussing a deduction allowable to a United States corporation on the mainland, but not in the Virgin Islands, we said:

> "Therefore, substantive equality of treatment in determining the deduction under the Virgin Islands mirror sytem requires that the quoted language be given the same meaning. Such identity of treatment imposes no unfairness and creates no distortion. The scheme of the statute is to impose a tax obligation to the Virgin Islands equivalent to what the United States would collect on the same income, but for the mirror system. *Cf. Sayre & Co. v. Riddell, supra* at 410-411. To disallow the deduction as the Virgin Islands has done is to

> claim for the territory a larger tax than the United States would have collected in the absence of the mirror system.
>
> * * *
>
> "More basically Congress has aided the Virgin Islands by giving them the same tax, nor more, than the United States would otherwise collect on Virgin Islands business." 430 F.2d at 977-978.

Guided by the equality principle for which *Chicago Bridge and Iron* stands, we hold that the Virgin Islands may not require withholding of the tax under §1442. The implication of Regulation 1.1441-4(d) allows no other conclusion.[7]

Citing the argument of the losing taxpayer in *Great Cruz Bay, supra*, the Commissioner argues that case undermined the equality emphasis of *Chicago Bridge and Iron, supra.* But *Great Cruz Bay* is distinguishable. The exemption sought under the statutory provisions pertaining to subchapter (S), which were under consideration there, was to be narrowly construed and no treasury regulation, such as 1.1441-4(d), entered into the decision. Accordingly, there is no conflict between that case and the one *sub judice.*

The judgment of the district court will be affirmed insofar as it requires Vitco to pay tax on its income to the Virgin Islands; the judgment will be vacated to the extent that it found an obligation on the part of Vitco

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[7] This appeal is concerned only with the assessment against Vitco. The tax liability of Chase Instruments Corporation is not before us.

to withhold a tax on the dividends payable to Chase Instruments Corporation.

TO THE CLERK:

Please file the foregoing opinion.

/s/Joseph Weis, Jr.
Circuit Judge

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 77-1065

VITCO, INC.,

Appellant

vs.

GOVERNMENT OF THE VIRGIN ISLANDS and REUBEN WHEATLEY, Commissioner of finance

(D.C. Civil No. 74-628)

ON APPEAL FROM THE DISTRICT COURT OF THE VIRGIN ISLANDS DIVISION OF ST. THOMAS AND ST. JOHN

Present: VAN DUSEN, WEIS and GARTH, *Circuit Judges*

JUDGMENT

This cause came on to be heard on the record from the District Court of the Virgin Islands, Division of St. Thomas and St. John and was argued by counsel on April 27, 1977.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, entered November 11, 1976, be, and the same is hereby affirmed insofar as it requires Vitco to pay tax on its income to the Virgin Islands and vacated insofar as it found an obligation on the part of Vitco to withhold a tax on the dividends payable to Chase Instruments Corporation, all in accordance with the opinion of this Court.

ATTEST:

/s/ [illegible]
Clerk

July 26, 1977

APPENDIX B

IN THE DISTRICT COURT OF THE
VIRGIN ISLANDS DIVISION OF
ST. THOMAS & ST. JOHN

CIVIL NO. 74/628

REDETERMINATION OF TAX DEFICIENCY

VITCO, INC.

Plaintiff

vs.

GOVERNMENT OF THE VIRGIN ISLANDS and
REUBEN WHEATLEY, Commissioner of Finance

Defendant

OPINION

This petition for redetermination of a tax deficiency is before the Court on stipulated facts. Operative facts, contained in the stipulation of the parties, and of high pertinence hereto are as follows:

1. The petitioner, Vitco, Inc., is a Virgin Islands corporation and is a wholly-owned subsidiary of Chase Instruments Corp., a New York corporation.

2. The respondent, Reuben Wheatley, was Commissioner of the Virgin Islands Department of Finance during all times pertinent to this proceeding and was the official who made the determination of the deficiency that is the subject matter of this proceeding.

3. At all times pertinent to this proceeding, the petitioner maintained a place of business at Lindenhurst, New York, and did not maintain a place of business in the Virgin Islands; all moneys paid to the petitioner for machine rentals and interest were physically received by it in the continental United States and were deposited in its bank accounts maintained in the continental United States.

4. During the years 1970, 1971 and 1972, the petitioner had no employees, office, or bank account in the Virgin Islands.

5. During the years 1970, 1971 and 1972, the business of the petitioner consisted solely of the leasing of machinery and equipment and the lending of money to Chase Instruments Corp., and another wholly-owned subsidiary of Chase Instruments Corp.

6. The petitioner earned income for rentals of machinery and equipment located in the continental United States and the Virgin Islands, as follows:

	Continental United States	*Virgin Islands*
1970	$17,421.00	$ 3,119.00
1971	26,243.00	4,102.00
1972	39,507.00	1,374.00

7. The petitioner earned income for interest from loans to corporations doing business in the continental United States and the Virgin Islands as follows:

	Continental United States	*Virgin Islands*
1970	$ 7,895.00	$13,495.00
1971	12,932.00	7,603.00
1972	14,309.00	1,571.00

8. During the calendar years 1971 and 1972, the petitioner purchased tangible personal property in the continental United States in the amount of $54,447.56 and $43,754.50, respectively, none of which was located in the Virgin Islands, and the proper computation of a seven per cent investment credit against petitioner's income taxes for those years is in the amounts of $3,811.33 and $3,062.82, respectively, if the petitioner is entitled to such investment credit.

9. The petitioner properly took deductions for depreciation of tangible personal property used in its business in the amounts of $13,277.05, $16,140.83, and $26,434.86 for the calendar years 1970, 1971, and 1972, respectively, in computing its income taxes under the Internal Revenue Code.

10. The petitioner paid dividends in the amounts of $25,000.00, $50,000.00, and $50,000.00 to its parent, Chase Instruments Corp., for the calendar years 1970, 1971 and 1972, respectively.

11. Within the appropriate times provided by law during each year, the petitioner duly caused to be filed with the Treasurer of the United States income tax returns for the tax years 1970, 1971, and 1972 and paid the taxes shown thereon to be due to the Treasurer of the United States.

12. Within the appropriate times provided by law during each year, the petitioner caused to be filed with the Commissioner of Finance of the Virgin Islands income tax returns for the years 1970, 1971 and 1971 . . . and claimed thereon as foreign tax credits the income taxes paid to the Treasurer of the United States.

13. The respondent Government of the Virgin Islands, under date of July 17, 1974, forwarded to the petitioner a notice of deficiency. . . .

In the notice of deficiency three basic justifications for its issuance were noted. First was the assertion of the Commissioner of Finance for the United States Virgin Islands ("the Commissioner") that all of the tax on Vitco, Inc.'s ("Vitco") income, from whatever source, should have been returned to the treasury of the Virgin Islands. Second was the Commissioner's premise that depreciation deductions for the subject years were improperly taken, by reason of Vitco's failure to particularize the costs and the nature of the item for which entitlement to a depreciation deduction was claimed. Lastly, the Commissioner stated that, for each of the years in issue, Vitco, pursuant to IRC §1442, 26 U.S.C. §1442, should have withheld 30 percent of the dividends which it distributed to its United States based parent.

The depreciation issue, as noted, has been resolved by stipulation. Moreover, Vitco's claim that it should properly have been accorded a seven per cent investment credit, due to its purchase of depreciable property in 1971 and 1972, has been acknowledged by the Commissioner, in his brief, to be justified. The only questions remaining for decision, then, are (a) whether Vitco properly satisfied all its income tax obligation in the United States, and (b) whether Vitco was correct in not withholding the aforementioned 30 per cent of the dividends which it distributed to its mainland parent.

Before proceeding to a resolution of the remaining issues, I pause to make mention of the fact that the Virgin Islands, as an unincorporated territory of the United States, is a separate taxing jurisdiction. See *Chicago Bridge & Iron Co., Ltd. v. Wheatley*, 430 F. 2d 973, 974 (3rd Cir. 1970); 48 U.S.C. §1541(a). Yet all

the income tax laws of the United States are made applicable to the Virgin Islands by virtue of 48 U.S.C. §1397 (July 12, 1921) c.44, §1, 42 Stat. 123[1]. A further indication of the special status of the Virgin Islands is found in the following language appearing in §28(a) of the Virgin Islands Revised Organic Act of 1954, 48 U.S.C. §1642:

> The proceeds of customs duties, the proceeds of the United States income tax, the proceeds of any taxes levied by the Congress on the inhabitants of the Virgin Islands . . . shall be covered into the treasury of the Virgin Islands. . . . Provided, That the term 'inhabitants of the Virgin Islands' as used in this section shall include all persons whose permanent residence is in the Virgin Islands, and such persons shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands. . . .

The import of the quoted provision is clear. No matter where the income may have been earned, a permanent resident of the Virgin Islands must pay the tax on all such income into the coffers of the Government of the Virgin Islands.

Vitco has no quarrel with that interpretation of the statute. Rather, it contends that, despite the fact that it

[1] "The income tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands of the United States, except that the proceeds of such taxes shall be paid into the treasuries of said islands". This was part of the Naval Service Appropriations Act of 1922.

is a Virgin Islands corporation, it can no longer be characterized as a "permanent resident" within the meaning of §28(a) of the Revised Organic Act. It reasons that since it did not maintain a place of business in the Virgin Islands but did have an office in New York; had no bank accounts, employees, or offices in the Virgin Islands; physically received its income and depositied it in bank accounts in the United States; and carried on the bulk of its activities in the United States, it has somehow shifted its residency from the Virgin Islands to the United States.

Such reasoning, the respondents declare, flies squarely into the face of the teaching of *Chicago Bridge & Iron Company, supra* at 974, fn. 1:

> In 1954, Congress provided that permanent residents of the Virgin Islands (including Virgin Islands corporations) must return and pay taxes to the Virgin Islands on income from all sources. . . . However, corporations domiciled on the mainland and United States citizens not residing permanently in the Virgin Islands must still file two tax returns, one reporting and paying taxes to the Virgin Islands on Virgin Islands income, and the other reporting and paying taxes to the United States on income from all sources, with a credit for taxes paid to the Virgin Islands.

The petitioner characterizes the above as mere *dicta*, not necessary for a determination of the issues presented in the case before the Court of Appeals. Therefore, it argues, in the instant case this Court, unfettered by the strictures of judicial precedent, may determine that Vitco, although having been "born" in the Virgin Islands, has so clearly severed its connections with the Virgin Islands that it must now be deemed a

resident of the United States for income tax purposes. I am unable to accept this contention for the reasons which follow.

As noted, it has been stipulated by the parties that petitioner is a Virgin Islands corporation. As such, it is subject to our General Corporation Law, appearing at Title 13 of the Virgin Islands Code. That statute requires all corporations organized pursuant thereto to maintain a principal office or place of business in the Virgin Islands, to have a resident agent in the Virgin Islands[2] and to include the location of its principal office and the name of its resident agent in its articles of incorporation.[3] It appears that these particular statutory imposts are intended to serve the purpose of achieving some manner of permanence with regard to the relationship between a Virgin Islands corporation and the Virgin Islands,[4] *A fortiori*, it would seem that something more than the mere carrying on of business in another jurisdiction is necessary for a domestic corporation to sever the ties so cemented to the Virgin Islands. This record is devoid of any indication that any such act was undertaken. Thus, despite the fact that

[2] 13 V.I.C. §51.

[3] 13 V.I.C. §2.

[4] ". . . [S]tatutes in many of the jurisdictions require both a principal office and a registered agent, one or both of which must be listed in the articles of incorporation or in another document separately filed with the secretary of state. . . . Such requirements are written into the statute in order to secure service of process, determine venue, and for the purpose of general jurisdiction and taxation. . . . 8 *Fletcher Cyc Corp. (Perm Ed. 1966),* §4046 pp. 482-483.

during the relevant years Vitco did not maintain an office or place of business in the Virgin Islands, but did conduct business in the State of New York, in the absence of any showing that it formally and completely terminated its corporate status in the Virgin Islands, I find that Vitco, as a domestic corporation, retained its *principal* place of business (if only for the purpose of the Virgin Islands corporation law) in this jurisdiction. Therefore, as observed by the Court of Appeals for the Third Circuit in *Chicago Bridge & Iron Company, supra*, Vitco, as a permanent resident of the Virgin Islands, and pursuant to §28(a) of the Revised Organic Act of 1954, was obliged to pay tax on all its income, wherever earned, to the Virgin Islands Government.

The above conclusion is further buttressed by §11(a) of the Internal Revenue Code of 1954 which provides for a tax upon corporations. The pertinent Treasury Regulations establish that the tax is payable on corporate income from any source, as

> [i]t is immaterial that a domestic corporation . . . may derive no income from sources within the United States . . . 26 C.F.R. §1.11-1(a).

Substituting the words "Virgin Islands" for "United States" in accordance with the "mirror theory"[5], I

[5] According to the "mirror theory" implemented when interpreting the Virgin Islands income tax structure, and whereby the words "Virgin Islands" are to be substituted in appropriate places throughout the Internal Revenue Code, Vitco, as a Virgin Islands domestic corporation, was obliged to report all its income to the Virgin Islands rather than to the United States. 48 U.S.C. §1397 *supra*; 26 C.F.R. §301; 7701-5; See also, *Dudley v. C.I.R.*, 258 F.2d 1820 (3rd Cir. 1958); *Chicago Bridge & Iron Company v. Wheatley, supra; Great Cruz Bay, Inc. v. Wheatley*, 495 F.2d 301 (3rd Cir. 1974).

cannot but conclude that Vitco's petition for redetermination, insofar as it relates to the issue of the taxability by the Government of the Virgin Islands of all Vitco's income, must be denied.[6]

Shifting now to a consideration of the withholding issue, I find that this facet of Vitco's petition must also fall.

The petitioner has stipulated that it made dividend distributions to its parent, Chase Instruments Corporation ("CIC"), a New York corporation, during the subject years. Under 26 U.S.C. §881(a) (and again, pursuant to the "mirror" theory) there is an annual tax imposed by the Virgin Islands of 30 per cent of the amounts received by a foreign corporation from sources within the Virgin Islands.

As pointed out by counsel for the respondents, Treasury Regulations §1.861-3(a)(2) defines a dividend from a domestic corporation as income from a source within the Virgin Islands. It is required that the tax be withheld at its source by the payer of the dividend. 26 U.S.C. §1441(a). As applied to the facts of this case, these provisions imposed upon Vitco the duty to

[6] I so hold despite the fact that, pursuant to I.R.C. §864 and 882, petitioner had tax liability to the United States on the income it earned which was "effectively connected" with the United States. It appears to me that the proper course for Vitco to have taken in view of the special provisions of §28(a) of the Revised Organic Act would have been to take a foreign tax credit on its United States returns for the taxes owed to the Virgin Islands Government, which, of course, would have effectively negated Vitco's liability to the United States. In all likelihood Vitco still has the opportunity to rectify the situation by the filing of amended returns.

withhold 30 per cent of the dividends it paid to its "foreign" parent, for the purpose of remitting such funds to the Government of the Virgin Islands.

Petitioner maintains its parent is exempt from such a tax by reading 26 C.F.R. §1.1441-4(d)(1), as qualified by the "mirror" theory. That regulation states, in pertinent part, that

> [n]o withholding is required . . . upon any item of income paid to any person who at the time of payment reasonably expects to satisfy his income tax obligations with respect to that item under §28(a) of the Revised Organic Act of the Virgin Islands (48 U.S.C. §1642) . . . For the purpose of this paragraph, the term "person" shall include an individual, partnership, and corporation.

It is Vitco's contention that implementation of the "mirror" theory is necessary in this context with the result that C.I.C., the payee of the dividends from Vitco in the subject years, was exempt from the withholding tax. The petitioner reasons that since its corporate parent would satisfy its tax obligations with respect to the dividends to the United States, the C.I.C. within the intended coverage of Treasury Regulations §1.1441-4(d)1 and therefore escapes liability for the withholding tax. The weakness of this argument is patent.

The "mirror" theory is not a principle to be inflexibly and rigidly applied; rather, it should be resorted to only in appropriate situations. As it makes specific reference to the Virgin Islands and to §28(a) of the Revised Organic Act, Treasury Regulation §1.1441(d)1 is clearly intended to provide relief only to permanent residents of this territory. The directness and clarity of the language used permits no alternative

interpretation. Accordingly, I find and conclude that Chase Instruments Corporation, as a foreign corporation, was obliged to pay the 26 U.S.C.A. §881(a) tax, and petitioner was charged with the responsibility of withholding it for payment to the Virgin Islands.

As for sums due from petitioner in light of my conclusions on both of the issues considered in this opinion, I see no reason to alter the amounts stipulated to by the parties. The income tax liability of Vitco therefore is as follows:

1970	$ 8,084.80
1971	7,275.93
1972	6,007.61

The withholding tax liability of petitioner is

1970	$ 7,500.00
1971	15,000.00
1972	15,000.00

Let judgment enter accordingly.

Dated at Charlotte Amalie, St. Thomas, U.S. Virgin Islands this 14th day of October, 1976.

ENTER: /s/ Almeric L. Christian
ALMERIC L. CHRISTIAN
Chief Judge

ATTEST:

Signed
Clerk of Court

APPENDIX C

Naval Service Appropriation Act, 1922
42 Stat. 123, 48 U.S.C. §1397

§1397. Income tax laws of United States in force; payment of proceeds; levy of surtax on all taxpayers

The income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands to the United States, except that the proceeds of such taxes shall be paid into the treasuries of said islands: *Provided further*, That, notwithstanding any other provision of law, the Legislature of the Virgin Islands is authorized to levy a surtax on all taxpayers in an amount not to exceed 10 per centum of their annual income tax obligation to the government of the Virgin Islands.

Revised Organic Act of the Virgin Islands
§28(a), 68 Stat. 508, 48 U.S.C. §1642

§1642. Use of certain proceeds for expenditure; income tax obligations of inhabitants

The proceeds of customs duties, the proceeds of the United States income tax, the proceeds of any taxes levied by the Congress on the inhabitants of the Virgin Islands, and the proceeds of all quarantine, passport, immigration, and naturalization fees collected in the Virgin Islands, less the cost of collecting all of said duties, taxes, and fees, shall be covered into the treasury of the Virgin Islands, and shall be available for expenditure as the Legislature of the Virgin Islands may provide: *Provided*, That the term "inhabitants of the Virgin Islands" as used in this section shall include all persons whose permanent residence is in the Virgin Islands, and such persons shall satisfy their income tax obligations under

applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands: *Provided further*, That nothing in this chapter, sections 104 and 111 of Title 21, and section 3350(c) of Title 26 shall be construed to apply to any tax specified in section 3811 of Title 26. July 22, 1954, c. 558, § 28(a), 68 Stat. 508.

Internal Revenue Code of 1954

SEC. 881. TAX ON INCOME OF FOREIGN CORPORATIONS NOT CONNECTED WITH UNITED STATES BUSINESS.

(a) Imposition of Tax.–There is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a foreign corporation as–

(1) interest, (other than original issue discount as defined in section 1232(b)), dividends, rents, salaries, wages, premiums, annuities, compensations, remuneration, emoluments, and other fixed or determinable annual or periodical gains, profits, and income,

(2) gains described in section 631(b) or (c),

(3) in the case of–

(A) bonds or other evidences of indebtedness issued after September 28, 1965, and before April 1, 1972, amounts which under section 1232(a)(2)(B) are considered as ordinary income, and, in the case of corporate obligations issued after May 27, 1969, and before April 1, 1972, amounts which would be so considered but for the fact the obligations were issued after May 27, 1969,

(B) bonds or other evidences of indebtedness issued after March 31, 1972, and payable more than 6 months from the date of original issue (without regard to the period held by the taxpayer), amounts which under section 1232(a)(2)(B) would be considered as ordinary income but for the fact such obligations were issued after May 27, 1969, and

(C) the payment of interest on an obligation described in subparagraph (B), an amount equal to the original issue discount (but not in excess of such interest less the tax imposed by paragraph (1) thereon) accrued on such obligation since the last payment of interest thereon, and

(4) gains from the sale or exchange after October 4, 1966, of patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other like property, or of any interest in any such property, to the extent such gains are from payments which are contingent on the productivity, use, or disposition of the property or interest sold or exchanged, or from payments which are treated as being so contingent under section 871(e),

but only to the extent the amount so received is not effectively connected with the conduct of a trade or business within the United States.

(b) Exception for Guam Corporations.–For purposes of this section, the term "foreign corporation" does not include a corporation created or organized in Guam or under the law of Guam.

SEC. 1441. WITHHOLDING OF TAX ON NONRESIDENT ALIENS.

(a) Gėneral Rule.–Except as otherwise provided in subsection (c), all persons, in whatever capacity acting (including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States) having the control, receipt, custody, disposal, or payment of any of the items of income specified in subsection (b) (to the extent that any of such items constitute gross income from sources within the United States), of any nonresident alien individual, or of any foreign-partnership shall (except in the cases provided for in section 1451 and except as otherwise provided in regulations prescribed by the Secretary under section 874) deduct and withhold from such items a tax equal to 30 percent thereof, except that in the case of any item of income specified in the second sentence of subsection (b), the tax shall be equal to 14 percent of such item.

(b) Income Items.–The items of income referred to in subsection (a) are interest (other than original issue discount as defined in section 1232(b)), dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), amounts subject to tax under section 871(a)(1)(C), gains subject to tax under section 871(a)(1)(D), and gains on transfers described in section 1235 made on or before October 4, 1966. The items of income referred to in subsection (a) from which tax shall be deducted and withheld at the rate of 14 percent are–

(1) that portion of any scholarship or fellowship grant which is received by a non-resident alien individual who is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended, and which is not excluded from gross income under section 117(a)(1) solely by reason of section 117(b)(2)(B); and

(2) amounts described in subparagraphs (A), (B), (C), and (D) of section 117(a)(2) which are received by any such nonresident alien individual and which are incident to a scholarship or fellowship grant to which section 117(a)(1) applies, but only to the extent such amounts are includible in gross income. In the case of a nonresident alien individual who is a member of a domestic partnership, the items of income referred to in subsection (a) shall be treated as referring to items specified in this subsection included in his distributive share of the income of such partnership.

(c) Exceptions.–

(1) Income connected with United States business.–No deduction or withholding under subsection (a) shall be required in the case of any item of income (other than compensation for personal services) which is effectively connected with the conduct of a trade or business within the United States and which is included in the gross income of the recipient under section 871(b)(2) for the taxable year.

* * * * *

SEC. 1442. WITHHOLDING OF TAX ON FOREIGN CORPORATIONS.

(a) General Rule.–In the case of foreign corporations subject to taxation under this subtitle, there shall be deducted and withheld at the source in the same manner and on the same items of income as is provided in section 1441 or section 1451 a tax equal to 30 percent thereof; except that, in the case of interest described in section 1451 (relating to tax-free covenant bonds), the deduction and withholding shall be at the rate specified therein. For purposes of the preceding sentence, the references in section 1441(b) to sections 871(a)(1)(C) and (D) shall be treated as referring to sections 881(a)(3) and (4), the reference in section 1441(c)(1) to section 871(b)(2) shall be treated as referring to section 842 or section 882(a)(2), as the case may be, the reference in section 1441(c)(5) to section 871(a)(1)(D) shall be treated as referring to section 881(a)(4), and the reference in section 1441(c)(8) to section 871(a)(1)(C) shall be treated as referring to section 881(a)(3).

(b) Exemption.–Subject to such terms and conditions as may be provided by regulations prescribed by the Secretary, subsection (a) shall not apply in the case of a foreign corporation engaged in trade or business within the United States if the Secretary determines that the requirements of subsection (a) impose an undue administrative burden and that the collection of the tax imposed by section 881 on such corporation will not be jeopardized by the exemption.

(c) Exception for Guam Corporations.–For purposes of this section, the term "foreign corporation" does not

include a corporation created or organized in Guam or under the law of Guam.

* * * * *

SEC. 7701. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof–

* * * * *

(4) *Domestic* – The term "domestic" when applied to a corporation or partnership means created or organized in the United States or under the law of the United States or of any State or Territory.

(5) *Foreign* – The term "foreign" when applied to a corporation or partnership means a corporation or partnership which is not domestic.

* * * * *

TREASURY REGULATIONS

§ 1.1441-1 Requirement for withholding of tax on nonresident aliens, foreign partnerships, and foreign corporations.

Except as otherwise provided in §§1.1441-3, 1.1441-4, and 1.1441-6, to the extent that the items specified in §1.1441-2 constitute gross income from sources within the United States, withholding of a tax of 30 percent is required in the case of items of income specified in paragraphs (a) and (b) of §1.1441-2 when such income is paid to a nonresident alien individual, a foreign partnership, or a foreign corporation, except that with respect to payments made after March 4, 1964, withholding of a tax of 14 percent is required in the case of items of income specified in paragraph (c) of §1.1441-2. The rate of 30 percent or 14 percent

shall be reduced as may be provided by a treaty with any country. See section 894 and §1.1441-6, relating to income affected by treaty. For purposes of this section, the term "nonresident alien individual" includes an alien resident of Puerto Rico.

§ 1.1441-4 Exemptions from withholding.

* * * * *

(d) *Inhabitants of Virgin Islands–(1) Allowance of exemption.* No withholding is required under §1.1441-1 upon any item of income paid to any person who at the time of payment reasonably expects to satisfy his income tax obligations with respect to that item under section 28(a) of the Revised Organic Act of the Virgin Islands (48 U.S.C. 1642). That section provides that all persons whose permanent residence is in the Virgin Islands "shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the Treasury of the Virgin Islands." For the purpose of this paragraph, the term "person" shall include an individual, partnership, and corporation.

(2) *Claiming exemption.* To avoid withholding of tax at source under §1.1441-1, the payee of the income shall notify the withholding agent by letter in duplicate that he expects to satisfy his income tax obligations under section 28(a) of the Revised Organic Act of the Virgin Islands with respect to all income to be paid to him by the withholding agent during the current calendar year. This letter of notification shall constitute authorization to the payer of the income to pay income to the payee during that year without deduction of the tax at source under §1.1441-1.

(3) *Disposition of letter.* The duplicate copy of each letter of notification filed pursuant to subparagraph (2) of this paragraph shall be forwarded with a letter of transmittal to the Director of International Operations, Internal Revenue Service, Washington, D.C. 20225.

* * * * *

§ 1.1442-1 Withholding of tax on foreign corporations.

For regulations respecting the withholding of tax at source under section 1442 in the case of foreign corporations, see §§1.1441-1 and 1.1451-1.

APPENDIX D

Director of International Operations (Stamped) Aug. 28, 1967

Director, Income Tax Division T:I:C:2:3

Taxation of a United States citizen who resided in the United States and derived income from Virgin Islands sources.

Attention: CP:I0:63MM

This is in reply to your memorandum of January 17, 1967, identified as above. You request consideration of the possibility of inequities in the total income taxes, U.S. and Virgin Islands (V.I.), which could be payable under interpretations of the applicable statutes as being made by the V.I. tax authorities.

The inequities referred to are established, you stated, by U.S. resident citizens being required to file U.S. returns covering V.I. income and activities even though they have sustained overall (U.S. and V.I.) net losses. Also, you have learned that V.I. tax officials are giving consideration to the possibility of withholding at 30% under sections 1441 and 1442 from V.I.-source dividends paid to U.S. resident citizens and domestic corporations as if these were nonresident alien entities for purposes of V.I. taxation.

As your memorandum indicates, income taxation in the V.I., a possession of the U.S., is governed by the income tax laws of the U.S. by reason of the Naval Appropriations Act approved July 12, 1921 (42 Stat. 1224) and the Organic Act of the Virgin Islands

approved June 22, 1936 (49 Stat. 1807). Under rulings I.T. 2946, C.B. XIV-2, 109 and I.T. 3690, C.B. 1944, 164, the so-called "mirror" system was adopted with respect to taxation of U.S. citizens having V.I. income. It required generally that such U.S. citizens file returns both in the U.S. and in the V.I. Those (1) who were permanent residents of the V.I. reported income from all sources in both returns whereas those (2) not permanently residing in the V.I. reported only V.I.-source income in the V.I. return.

The requirement for the filing of two returns was eliminated with respect to category (1), above, by Rev. Rul. 60-291, C.B. 1960-2, 407, based on the provisions of the Revised Organic Act of the Virgin Islands approved July 22, 1954 (48 U.S.C. Supp. V. 1642), C.B. 1954-2, 595, a V.I. return only being required.

It is your suggestion that this revision pertaining to taxpayers in category (1) carries a strong implication that the other side of the coin is also applicable, i.e., that category (2) taxpayers should be required to file only a U.S. return. A question regarding this situation has been previously considered by this office at the request of the V.I. Government. Our ruling dated January 26, 1965, addressed to Mr. Reuben B. Wheatley, Assistant Commissioner of Finance, Charlotte Amalie, St. Thomas, held in effect that two returns are still required. Copy of that letter was furnished to your office.

We have given further careful consideration to the effect, if any, of the Revised Organic Act of the Virgin Islands on category (2) taxpayers. However, we can find no basis for departure from the "mirror" system of dual filings.

The possibility that the V.I. taxing authorities may require withholding at 30% under sections 1441 and 1442 of the 1954 Code from V.I.-source dividends paid to U.S. citizens and domestic corporations as if those were nonresidents alien entities for purposes of V.I. taxation is noted. You point out that some legal basis for the V.I. viewpoint could be found in I.T. 2946, referred to above. Actually, the latter ruling contains the very definite statement that "From the viewpoint of the Virgin Islands * * * citizens of the United States not residing in the Virgin Islands *must* be treated as nonresident aliens." (emphasis ours.) While this statement is keyed to a construction of the Revenue Act of 1934, it is equally applicable under the Internal Revenue Code of 1954 unless a basis exists for differentiation or for a change in position. A study of the question has not disclosed any such basis.

Although we recognize and are sympathetic toward the inequities presented, there are no remedies available under existing law.

(Signed) John W. S. Littleton
Director, Income Tax Division

APPENDIX E

INTERNAL REVENUE SERVICE
June 4, 1973
In reply refer to: CP:I0:63:JJZ

Mr. Max Kirchner
Government of the Virgin Islands
of the United States
Charlotte Amalie,
St. Thomas, Virgin Islands

Dear Mr. Kirchner:

This is in reply to your letter dated March 13, 1972, concerning the tax treatment of dividends paid by a corporation operating in the Virgin Islands to its United States parent corporation. We regret that we were not able to give you the technical assistance sooner.

The fact pattern submitted by you is as follows:

A Corporation is a wholly-owned subsidiary of *B* Corporation. Both corporations are organized in the United States pursuant to the laws of the State of Delaware.

A Corporation's sole source of income is from services rendered in the Virgin Islands. It files its income tax return with, and pays all of the tax shown due thereon, to the Virgin Islands Government. It maintains its offices in the Virgin Islands and all off its employees work there. It has no offices in the United States.

B Corporation's offices are in the United States. It has no income from sources within the Virgin Islands

apart from the dividend income described in the following paragraph. B owns all of the issued and outstanding stock of *A* Corporation.

In 1967, 1968 and 1969, *A* Corporation declared dividends of $200,000 payable in each of these years. *B* Corporation received $200,000 in each of these years by way of dividends from *A* Corporation. All dividends were paid out of current earnings.

The primary issue to be resolved is whether these dividends are taxable by the Virgin Islands to *B* Corporation and, if so, whether this tax is to be collected by *A* Corporation as the withholding agent.

The Internal Revenue Code of the United States was made applicable in the Virgin Islands by the Naval Service Appropriation Act of 1922, 48 U.S.C. 1397 (1970):

"The income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands of the United States, except that the proceeds of such taxes shall be paid into the treasuries of such islands."

Section 881 of the Internal Revenue Code provides, in relevant part, for the imposition of a tax of 30 percent of the amount received from sources within the United States by a foreign corporation as dividends.

Sections 1441 and 1442 of the Code provide, in relevant part, that in the case of foreign corporations subject to taxation, there shall be deducted and withheld at the source a tax equal to 30 percent.

The above United States Internal Revenue Code provisions would likewise be in force in the Virgin Islands of the United States and would allow the Virgin

Islands to withhold a tax of 30 percent on the dividends from the Virgin Islands subsidiary to the United States parent. For a similar result with respect to Guam, which also has a dual or "mirror" system of taxation in effect, see *Sayre & Co., Ltd. v. Riddell*, 395 F. 2d 407 (1968), reversing 378 F. 2d 372 (1967) and affirming D.C. Guam per curiam December 6, 1965.

Section 28(a) of the Revised Organic Act of the Virgin Islands provides, in part, that persons whose permanent residence is in the Virgin Islands shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands. As a corollary to this, section 1.1441-4(d) of the Income Tax Regulations provides an exemption from United States withholding requirements in the case of any item of income paid to any person, including a corporation, who at the time of payment reasonably expects to satisfy his income tax obligations with respect to that item under section 28(a) of the Revised Organic Act of the Virgin Islands.

The mirror system was designed to provide the Virgin Islands with its own separate tax system by duplicating provisions of the United States tax laws in all substantive particulars. But the Revised Organic Act of the Virgin Islands was enacted specifically for the Virgin Islands and is not a general provision of the United States income tax laws to be acquired by the Virgin Islands through the mirror system. *Cf.* section 934 of the Code. It would be inconsistent with legislative intent to interpret the Revised Organic Act of the Virgin Islands in a manner that would eliminate the

right of the Virgin Islands to tax the income of United States persons from sources within the Virgin Islands. See H.R. Rep. No. 1603, 83d Cong., 2d Sess. (1954). See also *Chicago Bridge & Iron Co. v. Wheatley*, 430 F. 2d 973, 974 (3d Cir. 1970). This conclusion is not affected by section 1.1441-4(d) of the Income Tax Regulations, which merely conforms tax withholding requirements to section 28(a) of the Revised Organic Act of the Virgin Islands without extending or altering the application of that statute.

Accordingly, *B* Corporation would be subject to tax by the Virgin Islands on dividends derived from sources within the Virgin Islands and a tax should therefore be collected by *A* Corporation as the withholding agent. *B* does not, by provision of section 28(a) of the Revised Organic Act of the Virgin Islands, satisfy its tax liability to the Virgin Islands by paying its tax on income from the Virgin Islands into the treasury of the United States.

Sincerely yours,

/s/ R. L. PLATE
Director,
International Operations

APPENDIX F

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. -----

GOVERNMENT OF THE VIRGIN ISLANDS
and
REUBEN B. WHEATLEY, Commissioner of Finance,
Petitioners

v.

VITCO, INC.,
Respondent

AFFIDAVIT

I, TERENCE A. TODMAN, first being duly sworn, depose and state:

1. I am the Assistant Secretary of State for Inter-American Affairs in the State Department of the United States Government.

2. In my capacity as Assistant Secretary of State, I am responsible for the oversight and development of United States foreign folicy in Latin America and the Caribbean.

3. The economic and financial welfare of the United States Virgin Islands is important to United States foreign policy in the Caribbean area.

4. The State Department considers strengthening the fiscal and economic viability of the Caribbean region as a whole highly important to U.S. national interests in this hemisphere, and is now engaged in a major

effort in cooperation with the other countries of the region to attain this objective.

5. Any. substantial impairment of the fiscal stability of the United States Virgin Islands would have an adverse effect upon United States foreign policy in the Caribbean area.

/s/ Terence A. Todman
Terence A. Todman

Subscribed and sworn to before me this 16th day of December, 1977, at Washington, D.C.

/s/Irene Ingalls
Notary Public

My commission Expires June 14, 1979

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-910

GOVERNMENT OF THE VIRGIN ISLANDS and
LEROY A. QUINN, Commissioner of Finance,

Petitioners,

v.

VITCO, INC.,

Respondent.

SUPPLEMENTAL MEMORANDUM IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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IN THE

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Respondent.

SUPPLEMENTAL MEMORANDUM IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Because it was judicial error for the Court below to deny to the Virgin Islands tax revenues Congress plainly meant for the Virgin Islands to receive, it is a judicial responsibility to correct that error. It would be no remedy to refer the Virgin Islands back to Congress or to the Internal Revenue Service.

The petition for certiorari in this case was filed December 23, 1977. On February 21, 1978, the Court entered an order inviting the Solicitor General to file a brief expressing the views of the United States. That brief was filed on March 23, 1978.

The Solicitor General agrees with Petitioner Virgin

Islands that the decision below is clearly erroneous, and that it will have an adverse impact upon the fiscal stability of the Government of the Virgin Islands. The Solicitor General urges, however, that the question involved does not warrant review by this Court. He says that the Virgin Islands can obtain relief by getting the United States Treasury to "amplify" the regulation which the Court of Appeals below wrongly thought applicable, or by persuading Congress to "clarify" the Virgin Islands' right to receive the taxes in issue. (Brief for the United States at 7-8).

The Solicitor General wholly overlooks the fact that whatever the appropriateness[1] or feasibility of such recourse might otherwise be, any corrective change to Treasury

[1]In *City of Lafayette* v. *Louisiana Power & Light Co.*, 46 U.S.L.W. 4265, 4270 (March 29, 1978), this Court rejected a similar argument that a Court be permitted to vitiate Congress' clear expression on the matter there in litigation in favor of reliance for remedy on the "vagaries of the political process" in the legislatures. Here, too, the Congress has spoken and should not be compelled to speak again to undo the interpretive evil of the decision of the Court of Appeals below.

Regulations,[2] the Code[3] or the Virgin Islands Organic Act will undoubtedly be of prospective effect only. If the decision of the Third Circuit is not reversed the Virgin Islands will be subject to refund suits[4] for the amount of the tax in issue collected in all prior open years, and will not be able to enforce outstanding deficiency notices for amounts due for those years. The revenues lost to the Virgin Islands will be at least $18,000,000 to $20,000,000, a devastating

[2]The Commissioner of Internal Revenue of course has discretion, pursuant to Section 7805(b) of the Code, to decide whether an "amplification" of Treasury Regulation 1.1441-4(d) should be retroactive, but there will be no way for the Virgin Islands to challenge a decision by him that any change should be prospective only. If this Court allows the Third Circuit's judgment to stand, such a decision by the Commissioner would hardly be an abuse of his discretion. Cf. *Dixon* v. *United States*, 381 U.S. 68, 76; *Automobile Club of Michigan* v. *Commissioner*, 353 U.S. 180, 184-86.

[3]Certainly, Congress will defer to judicial ruling on the proper interpretation of existing law, making any change prospective only. For example, in *Chicago Bridge and Iron Co.* v. *Wheatley*, 430 F.2d 973 (3d Cir. 1970), *cert. denied*, 401 U.S. 910, the Third Circuit held that the Virgin Islands could not deny to a United States corporation the "Western Hemisphere trade corporation" deduction available to it on a United States tax return. Congress thereafter eliminated the Western Hemisphere trade corporation deduction for purposes of application of the Internal Revenue Code in the Virgin Islands, thus in Respondent's words, "legislatively overruling *Chicago Bridge*." (Respondent's Brief In Opposition at 6, n.8.) However, the amendment was made effective only with respect to taxable years beginning after the date of its enactment, because Congress deferred to the Courts "as to what constitutes the appropriate interpretation of existing law..." H. Rep. No. 92-533, 92d Cong., 1st Sess. 50 (1971); S. Rep. No. 92-437, 92d Cong., 1st Sess. 71 (1971).

[4]In excess of $10,000,000 in claims for refunds and interest have already been filed by taxpayers identically situated with Respondent Vitco, Inc. In excess of $3,000,000 is subject to pending deficiency proceedings.

sum to a Government whose annual budget is less than $140,000,000 and whose fiscal position is already precarious. (Petition for Certiorari at 5-7).

Petitioners submit that, given the United States' position on the merits of this case, the appropriate disposition would be for this Court to enter an Order granting certiorari and summarily reversing the judgment of the Court of Appeals below. The only suitable alternative is full review on certiorari of the plainly erroneous decision of the Third Circuit.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-910

GOVERNMENT OF THE VIRGIN ISLANDS and LEROY A. QUINN, Commissioner of Finance,

Petitioners,

v.

VITCO, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENT VITCO, INC. IN OPPOSITION

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IN THE

Supreme Court of the United States

October Term, 1977

No. 77-910

Government of the Virgin Islands and
Leroy A. Quinn, Commissioner of Finance,

Petitioners,

v.

Vitco, Inc.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENT VITCO, INC. IN OPPOSITION

Respondent Vitco, Inc. ("Vitco") submits this brief in opposition to a petition for a writ of certiorari filed December 23, 1977. The petition seeks review of a unanimous decision of the United States Court of Appeals for the Third Circuit, holding that Vitco was not required to withhold a 30% Virgin Islands tax on dividends it paid to its United States parent corporation.

Questions Presented

1. Whether the "mirror system" of income taxation in force in the Virgin Islands includes the reciprocal of the United States income tax rule that United States source dividends received by Virgin Islands taxpayers are exempt

from United States withholding tax, thus exempting Virgin Islands source dividends received by United States taxpayers from Virgin Islands withholding tax.

2. Whether the United States statutes extending the United States income tax laws to the Virgin Islands may be interpreted to create a tax surcharge by authorizing the Virgin Islands to collect a tax on the gross investment income of United States taxpayers which in many cases will be larger than the tax on net income otherwise payable to the United States.

Statement of the Case

Vitco is a Virgin Islands corporation and a wholly-owned subsidiary of Chase Instruments Corp. ("Chase"), a New York corporation. During the years involved in this case, 1970, 1971 and 1972, Vitco carried on business only in the United States. In those same years, Vitco's taxable income was $38,660.80, $47,216.59, and $58,067.23, respectively, most of which was derived from sources outside the Virgin Islands, and Vitco paid dividends of $25,000, $50,000 and $50,000, respectively, to Chase. No income taxes payable to the Virgin Islands were withheld from these dividends. In a notice of deficiency dated July 17, 1974, addressed to Vitco, the then Commissioner of Finance of the Virgin Islands proposed assessment of a 30% tax which the Commissioner asserted that Vitco should have withheld from the dividends paid to Chase and should have remitted to the Virgin Islands Government.

On October 29, 1974, Vitco filed a petition for redetermination of this proposed deficiency in the United States District Court for the Virgin Islands. The District Court ruled that Vitco should have withheld the tax (Pet. App. B). On appeal, the United States Court of Appeals for the

Third Circuit unanimously reversed the District Court (Pet. App. A). The Court of Appeals held that Treas. Reg. § 1.1441-4(d), which proscribes a United States withholding tax on dividends paid by a United States corporation to a Virgin Islands corporation, is a valid application of the Revised Organic Act of the Virgin Islands and that a mirroring of this regulation as well as of the underlying statute bars the Virgin Islands from withholding tax on dividends paid by a Virgin Islands corporation to a United States corporation (Pet. App. 10a). The Court of Appeals found that Congress previously had utilized this type of mirroring to proscribe Guamanian withholding and thus "obviously" intended a "mirror system" of taxation to operate in this manner (Pet. App. 11a-12a). Finally, the Court of Appeals stated that its result was consistent with the "tax equality" principle established in its prior decision in *Chicago Bridge and Iron Company, Ltd.* v. *Wheatley*, 430 F.2d 973 (1970), *cert. denied*, 401 U.S. 910 (1971) (Pet. App. 12a-13a).

The Court of Appeals denied a motion for rehearing *en banc*, and petitioners now seek review in this Court.

Reasons for Denying the Writ

Under Rule 19.1 of this Court, a review on writ of certiorari will be granted "only where there are special and important reasons therefor." Rule 19.1(b) indicates the character of reasons which are sufficient to grant review, but petitioners nowhere assert any of them as a basis for review and none of them is present in this case. In fact, the withholding tax question decided by the Court of Appeals is *sui generis* to the Virgin Islands.

The only "special and important" reason that petitioners offer this Court as a basis for granting review is that the

Court of Appeals' decision will deprive the Virgin Islands of a substantial percentage of its revenues and thus will have an enormous adverse impact upon its fiscal stability. Nothing in the record supports this allegation, and petitioners offer no corroboration of their assertions. Moreover, their contention relates entirely to matters of local finance and is irrelevant to the interpretation of the governing statutes, which the Court of Appeals properly construed.[1] Petitioners' claim for relief should be addressed to Congress rather than to this Court.

I.

The Decision of the Court of Appeals Will Not Have a Disastrous Financial Impact on the Virgin Islands and Is in the Best Economic Interest of the Virgin Islands.

First, it should be pointed out that the loss of revenue that will result from the Court of Appeals' decision is not so extreme as petitioners would have this Court believe. The $4,000,000 to $6,000,000 that petitioners allege is collected annually by the withholding tax (Pet. 5) constitutes only 2.9% to 4.4% of the Virgin Islands' current operating budget of $137,000,000. A "Position Paper on 30% Withholding Tax" issued by the Economic Policy Council of the Office of the Governor of the Virgin Islands in December 1976 (the "Position Paper") states that the withholding tax makes only a "minor contribution" to Government revenues.[2]

---

[1] Petitioners advanced the same argument in support of their motion for a rehearing *en banc*, and the Court of Appeals denied the motion without even deeming it necessary to request opposing papers from respondent.

[2] Position Paper p. 9. A copy of the Position Paper was attached as Appendix A to respondent's reply brief to the Court of Appeals.

In addition, petitioners allege that the Virgin Islands has collected from $18,000,000 to $20,000,000 of withholding taxes that must be refunded if the Court of Appeals' decision is not reversed (Pet. 5).[3] Funds to repay these amounts are available to the Virgin Islands without causing cutbacks in governmental services. The Virgin Islands has unexercised taxing authority[4], and the Secretary of the Interior has estimated that through the expiration of industrial tax subsidies in 1978 and 1981 the annual revenues of the Virgin Islands will increase by up to $100,000,000.[5] If there is any temporary deficit after the use of these additional revenues, it should be noted that in 1976 and 1977

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[3] An affidavit filed by petitioners in support of their motion for rehearing *en banc* by the Court of Appeals states that all of the taxes which would be refunded were collected during the three years prior to entry of judgment in this case on July 26, 1977, *i.e.*, since July 1974. Respondent's petition to the District Court was filed on October 29, 1974. Thus, petitioners were on notice during most of the period these taxes were being collected that their validity was being challenged and that they might have to be refunded. If petitioners now have difficulty in finding money to refund these taxes, it is their own fiscal misbehavior in failing to reserve against the possibility that they might lose this case—not the decision of the Court of Appeals—that has produced that result.

[4] Since August 19, 1976, the Virgin Islands has had the authority to impose an annual 10% income tax surcharge. Act of Aug. 19, 1976, Pub. L. No. 94-392, § 5, 90 Stat. 1195 (codified at 48 U.S.C. § 1397 (Supp. 1977)), *amending* Naval Service Appropriations Act, 48 U.S.C. § 1397 (1970). (The text of § 1397 set forth in Pet. App. 1c contains the amended language.) The Virgin Islands Executive Budget—Fiscal Year 1978 estimated that the surcharge would raise approximately $6,500,000 per annum. However, the Virgin Islands legislature has never authorized the surcharge. It ill behooves petitioners to imply to this Court that the Virgin Islands has no additional sources of revenue when for almost a year and a half it has possessed this unexercised taxing authority.

[5] Letter dated April 7, 1976 from Secretary of the Interior Kyl to Vice President Rockefeller, H. Rep. No. 94-1080, 94th Cong., 2d Sess. 5 (1976); S. Rep. No. 94-1021, 94th Cong., 2d Sess. 8-9 (1976).

Congress authorized appropriations of $8,500,000 and $14,000,000,[6] respectively, for the Virgin Islands. *See* Act of Aug. 19, 1976, Pub. L. No. 94-392, § 4, 90 Stat. 1195 (codified at 48 U.S.C. § 1574d (Supp. 1977)); Act of Oct. 15, 1977, Pub. L. No. 95-134, § 402, 91 Stat. 1163. The Virgin Islands therefore may realistically apply to Congress for financial assistance.[7] The Virgin Islands can also ask Congress to change legislatively the result reached by the Court of Appeals.[8]

Finally, there is a substantial body of opinion in the Virgin Islands which holds that collection of the 30% withholding tax would be detrimental to the economy of the Virgin Islands. In a July 22, 1976 letter to his constituents, Virgin Islands Congressional Delegate de Lugo stated:

> "I strongly believe that the foreign treatment of U.S. investment income in the Virgin Islands under the Cruz Bay decision is fundamentally unsound in terms of the long-range interests of our Territory. I believe that subjecting such income to a 30% withholding tax will ultimately dry up investment in the Virgin Islands to the point where there may be little left to tax."[9]

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[6] The Virgin Islands will also receive its proportionate share of an estimated total payment of $15,000,000 to be made to American Samoa, Guam and the Virgin Islands in fiscal year 1978. Tax Reduction Act of 1977, Pub. L. No. 95-30, § 407, 91 Stat. 156; S. Rep. No. 95-66, 95th Cong., 1st Sess. 37-38 (1977).

[7] In S. Rep. No. 95-332, 95th Cong., 1st Sess. 19 (1977), the Committee on Energy and Natural Resources stated:

> "We support the concept of assisting the territories when they have tax losses which are beyond their control and which cause significant problems in their local economies."

[8] For example, in 1971 Congress gave the Virgin Islands more revenues by legislatively overruling *Chicago Bridge and Iron Company, Ltd.* v. *Wheatley, supra* (Pet. 9 n.1).

Similarly, in December 1974, the Virgin Islands legislature adopted Resolution No. 730, which stated that the "mirror system" of taxation, including withholding taxes, should be modified where it creates a Virgin Islands tax larger than the tax that would be payable to the United States if the Virgin Islands were a state of the United States. Since the 30% withholding tax frequently has that effect[10], the Court of Appeals' decision not only is legally correct but also is in the best interests of the Virgin Islands.[11]

II.

The Decision of the Court of Appeals Properly Interpreted the Relevant Statutes and Is in Accord with Congressional Policy.

Petitioners ask the Court to overturn a statutory interpretation adopted by a unanimous panel of the Third Circuit Court of Appeals and recognized by the Virgin Islands for more than 50 years in the administration of its system of taxation.[12] As the balance of this brief shows, the

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[9] In his letter, Congressman de Lugo also stated: "I am convinced that proposals can be developed which will address the immediate problems posed by the mirror theory without loss of revenue for the local Government."

[10] See discussion *infra* at page 14.

[11] A similar conclusion was reached by Congress in 1972 when, as noted by the Court of Appeals (Pet. App. 12a), it concluded that the Guamanian withholding tax should be eliminated because it "had the effect of seriously retarding investments by U.S. corporations in Guam." H. Rep. No. 92-1479, 92d Cong., 2d Sess. 3 (1972).

[12] Not until 1974 did the Virgin Islands generally attempt to collect the withholding tax on payments of income to United States taxpayers. Position Paper p. 1.

Court of Appeals' decision reciprocates long-standing Treasury Regulations, is consistent with recent actions of Congress in applying a similar statute, and reflects Congress' purposes in enacting the pertinent laws.

a. The Virgin Islands "Mirror System" Includes Treas. Reg. § 1.1441-4(d) and Proscribes a Withholding Tax on the Virgin Islands Source Passive Income of United States Taxpayers.

In 1921, Congress enacted the Naval Service Appropriations Act, 48 U.S.C. § 1397 (1970) (Pet. App. 1c), which in general provides that the Federal income tax laws extend to the Virgin Islands but that the proceeds collected thereby will be kept by the Virgin Islands, rather than the United States. Later interpretations of and references to the scheme of taxation created by the Naval Service Appropriations Act have dubbed it the "mirror system" of taxation and have established the general principle that in applying United States income tax laws in the Virgin Islands, the words "Virgin Islands" should be substituted for "United States" wherever appropriate. *See, e.g., Great Cruz Bay, Inc.* v. *Wheatley*, 495 F.2d 301 (3d Cir. 1974); *Chicago Bridge and Iron Company, Ltd.* v. *Wheatley, supra*; *Dudley* v. *Commissioner*, 258 F.2d 182 (3d Cir. 1958).

Petitioners contend that Section 1.1441-4(d) of the income tax regulations of the United States Treasury Department (Pet. App. 8c-9c) is not part of the United States income tax laws to be "mirrored" in the administration of those laws by the Virgin Islands. Treas. Reg. § 1.1441-4(d) provides that the United States 30% withholding tax imposed by I.R.C. §§ 871 and 881 on the United States source passive income of nonresident aliens and foreign corporations will not apply in the case of Virgin Islands taxpayers. If Treas. Reg. § 1.1441-4(d) is mirrored, the Virgin Islands cannot impose the 30% withholding tax on the Virgin Islands source passive income of United States taxpayers.

The historical background of Treas. Reg. § 1.1441-4(d), which petitioners ignore but which was before the Court of Appeals, establishes that the regulation is an essential component of the Federal income tax laws to be mirrored by the Virgin Islands. The rule contained in Treas. Reg. § 1.1441-4(d) was not first established as a result of enactment in 1954 of Section 28(a) of the Revised Organic Act of the Virgin Islands, 48 U.S.C. § 1642 (1970) (Pet. App. 1c-2c) (the "Revised Organic Act"), as petitioners suggest, but dates from 1921 and reflects Congress' understanding of how a "mirror system" operates.[18]

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[18] Section 260 of the Revenue Act of 1921, which governed the taxation of citizens of United States possessions (who are not otherwise citizens of the United States) residing in the possessions, provided that, as between it and the Naval Service Appropriations Act, the latter controlled. A regulation promulgated under Section 260 contemporaneously with the enactment of these statutes provided that payments of United States source passive income to possessions citizens generally were subject to United States withholding tax but, on the basis of the Naval Service Appropriations Act, properly stated that payments to citizens and residents of the Virgin Islands were not subject to such tax. Reg. 62, Art. 1121. This statute, and the regulation thereunder, were re-enacted in every subsequent Revenue Act and in the Internal Revenue Code of 1939. *See* § 260 of the Revenue Acts of 1924 and 1926 and §§ 252(a) and (b) of the Revenue Acts of 1928, 1932, 1934, 1936 and 1938 and the Internal Revenue Code of 1939; Reg. 65, Art. 1121 (Revenue Act of 1924); Reg. 69, Art. 1121 (Revenue Act of 1926); Reg. 74, Art. 1141 (Revenue Act of 1928); Reg. 77, Art. 1141 (Revenue Act of 1932); Reg. 86, Art. 252-1 (Revenue Act of 1934); Reg. 94, Art. 252-1 (Revenue Act of 1936); Reg. 101, Art. 252-1 (Revenue Act of 1938); Reg. Sec. 19.252-1 (Internal Revenue Code of 1939). The statutory provision was re-enacted when the Internal Revenue Code was reorganized in 1954, *see* I.R.C. § 932(b), but the non-withholding rule embodied in the prior regulations (whose language was revised to reflect enactment of the Revised Organic Act) was moved to the portion of the regulations relating to withholding.

The prior regulations referred only to individuals, whereas the new regulation applies to individuals and corporations. There is no basis for distinguishing between corporations and individuals, *see Sayre & Company* v. *Riddell*, 395 F.2d 407 (9th Cir. 1968), particularly where the relevant statute, the Naval Service Appropriations Act, draws no such distinction.

Petitioners ignore the pre-1954 history of the "mirror system" and contend that the Virgin Islands need not mirror the present United States rule of nonwithholding because it refers to and, hence, derives its authority solely from, the Revised Organic Act. They argue that the purpose of that statute was to divert to the Virgin Islands revenues previously collected by the United States and that a mirroring of Treas. Reg. § 1.1441-4(d) would defeat that purpose by taking away from the Virgin Islands the revenues generated by the 30% withholding tax (Pet. 10). The obvious failing of this argument is that in 1954 the Virgin Islands did not have authority to collect the 30% withholding tax: the United States nonwithholding rule antedated the Revised Organic Act. Petitioners cite no authority for the proposition that either the Internal Revenue Code of 1954 or the Revised Organic Act affirmatively granted to the Virgin Islands the authority to collect the 30% withholding tax, which it previously did not have, did not then attempt to obtain, and did not claim to have until 1974, twenty years later. There is no authority for that proposition.[14]

To the contrary, the technique used by Congress to overturn a Ninth Circuit decision[15] approving Guam's right to collect the 30% withholding tax under its "mirror system" demonstrates that the Court of Appeals' interpretation of the Virgin Islands "mirror system" is correct.

[14] Petitioners' citation of H. Rep. No. 1603, 83d Cong., 2d Sess. 13 (1954) (Pet. 10), as to the purpose of Congress in enacting this statute is highly misleading since the House Report deals only with excise taxes and not income taxes. The Revised Organic Act did divert to the Virgin Islands the Federal income tax on the United States source *business* income of Virgin Islands taxpayers, which theretofore had been payable to the United States.

[15] *Sayre & Company* v. *Riddell*, 395 F.2d 407 (1968), discussed below.

As the Court of Appeals noted (Pet. App. 11a), Congress did not enact a statute saying that Guam could not collect the withholding tax. Instead, it amended I.R.C. §§ 881 and 1442 to provide that the United States could not collect the withholding tax on United States source passive income paid to Guamanian corporations. *See* Act of Oct. 31, 1972, Pub. L. No. 92-606, § 1, 86 Stat. 1494. With respect to this legislation, the House Ways and Means Committee stated:

> "To eliminate the disincentive described above, your committee's bill amends the U.S. tax laws (section 1(e) of the bill) to provide that Guamanian corporations are not to be treated as foreign corporations for purposes of the 30-percent tax (sec. 881) or for the purpose of the provisions (sec. 1442) providing for the withholding of that tax. Since Guam's tax law is the 'mirror image' of the U.S. law, this means that under their tax law U.S. corporations will not be treated as foreign corporations for purposes of the 30-percent tax (sec. 881) or for purposes of the withholding of that tax (sec. 1442)." H. Rep. No. 92-1479, 92d Cong., 2d Sess. 3 (1972).

Similarily, the long-standing rule against a United States withholding tax on payments of such income to Virgin Islands taxpayers establishes the "mirror rule" that the Virgin Islands may not tax payments passing in the other direction.[16]

Petitioners' reliance on two unpublished communications of the Internal Revenue Service (Pet. 10) demonstrates the

[16] Petitioners' statement (Pet. 10) that the United States payee of Virgin Islands source dividends is "indisputably liable for the tax" is patently incorrect. It mistakenly assumes that § 881 applies to payments of United States source income to Virgin Islands residents. Since I.R.C. § 881 and its predecessors have never applied to such payments, the result sought by petitioners requires mirroring a nullity.

extent to which they have stooped in seeking support for their position. The legislative history of I.R.C. § 6110(j)(3) makes it clear that internal communications such as these may not be used or cited as legal precedent.[17] S. Rep. No. 94-938, 94th Cong., 2d Sess. 311 (1976); Staff of the Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976 309 (1976).

b. Collection of the Withholding Tax by the Virgin Islands Would Contravene Congress' Intent in Enacting the Original Virgin Islands Taxing Statute and Congress' Opposition to Withholding Taxes on Possession Source Passive Income Received by United States Taxpayers.

In addition to their argument that Treas. Reg. § 1.1441-4 (d) should not be mirrored, petitioners contend that the Court of Appeals' decision is contrary to the "plain meaning" of the relevant statutes (Pet. 8). However, what petitioners have done is to offer their "plain meaning" of a label used to describe the Virgin Islands' scheme of taxation—the "mirror system"—as a substitute for analysis of the governing statute, the Naval Service Appropriations Act, and its legislative history.

Congress enacted that act for the purpose of subjecting Virgin Islands residents to the United States income tax, for which they previously had not been liable, and thus to make the Virgin Islands Government financially self-sufficient. 61 Cong. Rec. 1724, 3173 (1921). It achieved this result by "extending" the Federal income tax to the

[17] Even a *published* ruling of the Internal Revenue Service is entitled to no greater weight than the opinion of an agency lawyer and hence is of little aid in interpreting a tax statute. *Biddle* v. *Commissioner*, 302 U.S. 573, 582 (1938); *Stubbs, Overbeck & Associates* v. *United States*, 445 F.2d 1142, 1146-47 (5th Cir. 1971); *Estate of Lang* v. *Commissioner*, 64 T.C. 404, 406-07 (1975). If they could be cited lawfully, private communications of the Internal Revenue Service should carry, if possible, even less weight.

Virgin Islands. H. Rep. No. 229, 67th Cong., 1st Sess. 7 (1921). Neither by that Act nor by any later act relating to the Virgin Islands did Congress purport to increase the total amount of tax payable to the United States and the Virgin Islands by a United States taxpayer. No decision, judicial or administrative, interpreting those statutes has had that result.

Chicago Bridge and Iron Company, Ltd. v. *Wheatley*, *supra*, interpreted the governing statutes in a manner consistent with this analysis of the legislative history. In an opinion by Judge Hastie, a former Governor of the Virgin Islands and a former United States District Court judge for the Virgin Islands, the Third Circuit Court of Appeals held that the Internal Revenue Code as a separate taxing statute in the Virgin Islands does not treat a United States corporation as "foreign" where to do so would violate the scheme of the statute, which

> "is to impose a tax obligation to the Virgin Islands equivalent to what the United States would collect on the same income, but for the mirror system." 430 F.2d at 977.

The Court also stated:

> "Congress has aided the Virgin Islands by giving them the same tax, not more, than the United States would otherwise collect on Virgin Islands business." 430 F.2d at 978.[18]

[18] Contrary to petitioners' assertion (Pet. 8), these statements were not dicta but were central to the Third Circuit's decision. Petitioners' contention (Pet. 8-9) that *Chicago Bridge* was "clearly inconsistent with the plain meaning of I.R.C. §§ 922 and 7701(a), as mirrored" is equally erroneous; when Congress overruled the result in that case, both Congressional committees explicitly stated that no inferences were to be drawn as to what constituted the appropriate interpretation of existing law in cases affected by the amendment. H. Rep. No. 92-533, 92d Cong., 1st Sess. 50 (1971); S. Rep. No. 92-437, 92d Cong., 1st Sess. 71 (1971).

The 30% withholding tax would contravene those principles and generate a tax liability for many United States taxpayers that invest in the Virgin Islands which would be larger than that payable if they had invested in the United States. It thus would create a tax surcharge on many investments in the Virgin Islands of the kind Congress never intended to impose and in 1972 acted to prevent in the case of Guam.[19] In overruling the Guamanian 30% withholding tax, the House Ways and Means Committee stated:

> "Since no deductions are allowed, the tax on this income, in many cases, is higher than the regular corporate tax would be if deductions were allowed. Even though the United States allows a foreign tax credit for taxes paid to its possessions (including Guam), this tax rate, since it is on a gross basis, is likely to be higher than the regular U.S. corporate tax rate. The fact that this income now is usually taxed at a higher rate than similar income earned in the United States has had the effect of seriously retarding investments by U.S. corporations in Guam." H. Rep. No. 92-1479, 92d Cong., 2d Sess. 3 (1972).

The Virgin Islands withholding tax is the same tax that Congress denied to Guam and thus for many taxpayers would be higher than the regular United States corporate tax on net income.[20]

[19] Petitioners apparently attempt to disguise this tax surcharge by references to tax subsidies granted to respondent (Pet. 12). Such subsidies are granted to corporations doing business in the Virgin Islands, whereas the 30% withholding tax would be imposed on the shareholders of such corporations and would be payable whether or not the corporations have subsidies. In addition, the withholding tax would apply to interest, rents and royalties.

[20] In the case *sub judice*, a substantial portion of the dividends that Chase received from Vitco were eligible for the 85% dividends-received deduction under I.R.C. § 245 and hence to that extent were nontaxable in the United States.

Petitioners argue (Pet. 10-11) that the decision of the Ninth Circuit Court of Appeals in *Sayre & Company* v. *Riddell*, 395 F.2d 407 (1968), supports their contention that the tax equality principle of *Chicago Bridge* is incorrect. Although *Sayre* approved collection of the 30% withholding tax by Guam under its mirror system, the Guamanian mirror system differed from that in force in the Virgin Islands. When *Sayre* was decided, there was no act of Congress and there were no Treasury Regulations proscribing a United States withholding tax on the United States source passive income of Guamanian taxpayers. On the other hand, since the inception of the "mirror system" in the Virgin Islands, Treasury Regulations interpreting the governing statutes have specifically prohibited the United States from withholding tax on similar payments to Virgin Islands taxpayers. Also, of course, the result in *Sayre* was overturned by Congress in 1972. Pub. L. No. 92-606, *supra*.

Petitioners contend (Pet. 12) that, because Congress did not prohibit withholding by the Virgin Islands at the time it did so for Guam, Congress must have approved the Virgin Islands withholding tax. This argument is deficient because in 1972 the Virgin Islands was not asserting the right to collect the tax and had not done so since its "mirror system" was established more than 50 years before. Moreover, as indicated above, a mirroring of United States law and regulations by the Virgin Islands (by the method Congress established for Guam in 1972) already prohibited the Virgin Islands from collecting the tax. Thus, following enactment in 1972 of the legislation as to Guam, there was no withholding on dividends paid in either direction between the United States and Guam and between the United States and the Virgin Islands.

As a final attempt to derive support for their position, petitioners cite a provision in the House Ways and Means

Committee version of what finally became the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (Pet. 12-13). This provision would have abolished collection of the 30% withholding tax by the United States on dividends and interest paid on certain "portfolio investments" held by nonresident aliens and foreign corporations, but would have retained the tax for the Virgin Islands. There is no indication in the legislative history that the Committee recognized any authority of the Virgin Islands to withhold tax on the income of United States taxpayers. Instead, the Committee would only have preserved whatever authority the Virgin Islands already had, including the indisputable authority to collect the tax on payments to taxpayers foreign as to both the United States and the Virgin Islands. Petitioners inexplicably fail to note that in 1976, after the full House of Representatives had removed the proposed withholding tax exemption, the Senate Finance Committee reinstated it for interest income without preserving any authority for the Virgin Islands to collect the tax. H. R. 10612, 94th Cong., 2d Sess., 121 Cong. Rec. 10981 (daily ed. June 29, 1976); S. Rep. No. 94-938, 94th Cong., 2d Sess. 258-61 (1976).[21] No Congressional consensus, let alone legislation, developed on this issue.

[21] The full Senate deleted this exemption, and it was never enacted. 121 Cong. Rec. 12508 (daily ed. July 26, 1976).

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

Dated: January 20, 1978

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-910

GOVERNMENT OF THE VIRGIN ISLANDS and LEROY A. QUINN, Commissioner of Finance,

Petitioners,

v.

VITCO, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

SUPPLEMENTAL MEMORANDUM OF RESPONDENT VITCO, INC. IN OPPOSITION

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SUPPLEMENTAL MEMORANDUM OF RESPONDENT VITCO, INC. IN OPPOSITION

Petitioners' supplemental memorandum presents no facts or contentions not raised in their petition. The allegation in petitioners' supplemental memorandum that the decision of the Court of Appeals will have a "devastating" effect on the economy of the Virgin Islands was explicitly refuted in respondent's brief in opposition at pages 4-7, which demonstrated that funds adequate to repay all previously collected taxes are or can readily be made available to the Virgin Islands. Petitioners nowhere even attempt to address this refutation. Petitioners' allegation of dire economic harm was implicitly dismissed by the Solicitor General in recommending denial of a writ of certiorari.

Moreover, petitioners do not contest the primary basis for the Solicitor General's recommendation:

> "The technical narrow issue is limited to the Virgin Islands and does not affect the tax administration of any of the other territories." (Brief for the United States, at 7.)

The unanimous decision of the Court of Appeals is a correct interpretation of Virgin Islands tax law and should not be reviewed by this Court.

Dated: April 11, 1978

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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is submitted in response to the Court's invitation to the Solicitor General to express the views of the United States.

QUESTION PRESENTED

Whether a Virgin Islands corporation, which is a subsidiary of a United States corporation, is required to withhold the 30 percent Virgin Islands tax on dividends distributed to its United States parent.

STATUTES INVOLVED

The pertinent parts of Section 1, Act of July 12, 1921, 42 Stat. 122 (48 U.S.C. 1397), of Section 28(a), Revised Organic Act of the Virgin Islands, 68 Stat. 508 (48 U.S.C.

1642), and of Sections 881, 1441, 1442 and 7701 of the Internal Revenue Code of 1954, as amended (26 U.S.C.), are set forth at Pet. App. C, pp. 1c-7c.

STATEMENT

Respondent is a Virgin Islands corporation and a wholly-owned subsidiary of Chase Instruments Corporation, a New York corporation. During the years in issue, 1970 through 1972, respondent had no office or employees in the Virgin Islands. It maintained its principal place of business together with its parent in Lindenhurst, New Jersey. Respondent's business consisted primarily of leasing machinery and equipment, which was located in the Virgin Islands and in the continental United States. Most of respondent's revenues were attributable to equipment located in the continental United States. Respondent received its machinery rental and interest income in the United States (Pet. App. A, p. 3a; Pet. App. B, pp. 2b-3b).

During 1970-1972, respondent filed United States corporate income tax returns and paid United States taxes on its income from equipment leasing and interest. It also filed income tax returns with the Commissioner of Finance of the Virgin Islands for the same years, and claimed the taxes it paid to the United States as foreign tax credits. However, the Commissioner of Finance of the Virgin Islands took the position that respondent should have paid taxes on all of its income to the Virgin Islands rather than to the United States and should have withheld the 30 percent tax on the gross amount of dividends respondent paid to its parent, Chase (Pet. App. A, p. 3a; Pet. App. B, pp. 3b-4b). The district court ruled in favor of the Government of the Virgin Islands (Pet. App. B, pp. 1b-11b).

The court of appeals reversed. It agreed with the district court that respondent was required to pay tax on all of its income to the Virgin Islands (Pet. App. A, pp. 1a-8a). However, it held that respondent was not required to withhold the 30 percent tax on the dividends distributed to Chase (Pet. App. A, pp. 9a-14a). Although the court acknowledged that 26 U.S.C. 1442 as applied in the Virgin Islands "standing alone, would appear to authorize the Virgin Islands to require Vitco, a Virgin Islands source, to withhold 30% of the dividends payable to Chase, a foreign corporation" (Pet. App. A, p. 9a), it concluded that Treasury Regulations, Section 1.1441-4(d) (26 C.F.R.), "provides a special exemption [for inhabitants of the Virgin Islands] which negates the apparent effect of the statute" (Pet. App. A, p. 10a).

ARGUMENT

1. a. Since the enactment of the Naval Service Appropriations Act of July 12, 1921, 42 Stat. 122, Congress has prescribed that "[t]he income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands of the United States, except that the proceeds of such taxes shall be paid into the treasuries of said islands * * *" (48 U.S.C. 1397; Pet. App. C, p. 1c).

The Act created a separate territorial income tax for the Virgin Islands based upon the United States tax law. However, to give the Internal Revenue Code proper effect in applying it to the Virgin Islands, the words "Virgin Islands" are generally to be substituted for the words "United States." Similarly, Virgin Islands corporations are domestic corporations under the Virgin Islands tax law; conversely, United States corporations are deemed to be foreign corporations. Since the Virgin Islands tax law

is the Internal Revenue Code with the necessary changes to reflect the Virgin Islands, the reverse nomenclature of the Virgin Islands tax law is commonly described as a "mirror" provision. *Dudley* v. *Commissioner*, 258 F. 2d 182, 185 (C.A. 3); *Chicago Bridge and Iron Co.* v. *Wheatley*, 430 F. 2d 973, 975 (C.A. 3), certiorari denied, 401 U.S. 910; *Great Cruz Bay, Inc., St. John, Virgin Islands* v. *Wheatley*, 495 F. 2d 301, 302-305 (C.A. 3); *Sayre & Company* v. *Riddell*, 395 F. 2d 407, 408-409, 411-413 (C.A. 9) (*en banc*); S. Rep. No. 92-437, 92d Cong., 1st Sess. 70 (1971); S. Rep. No. 1767, 86th Cong., 2d Sess. 2-3 (1960); S. Rep. No. 2176, 85th Cong., 2d Sess. 5-6 (1958); I.T. 2946, XIV-2 Cum. Bull. 109 (1935), superseded by Rev. Rul. 73-315, 1973-2 Cum. Bull. 225.

Section 881 of the 1954 Code (Pet. App. C, pp. 2c-3c), as applied in the Virgin Islands, imposes a 30 percent tax on certain types of Virgin Islands-source income, such as dividends and interest received by foreign corporations, when that income is not effectively connected with the conduct of a trade or business in the Virgin Islands. Sections 1441 and 1442 of the Code (Pet. App. C, pp. 4c-7c) require the payor of such income to withhold 30 percent of the gross amount paid to the foreign corporation to insure that the Virgin Islands tax is paid. In this case, the import of these statutes is that Chase is liable for Virgin Islands tax upon the dividends it received from respondent and that respondent was required to withhold 30 percent of the gross amount of the dividends paid to Chase.

b. The court of appeals acknowledged that "[u]sing the mirror technique, the statute, standing alone, would appear to authorize the Virgin Islands to require Vitco, a Virgin Islands source, to withhold 30% of the dividends

payable to Chase, a foreign corporation" (Pet. App. A, p. 9a). However, it held that Section 1.1441-4(d) of the Treasury Regulations "provides a special exemption which negates the apparent effect of the statute" (Pet. App. A, p. 10a).

The Regulation provides an exemption from the withholding requirements for payments of income to certain inhabitants of the Virgin Islands. It states as follows:

> No withholding is required under § 1.1441-1 upon any item of income paid to any person who at the time of payment reasonably expects to satisfy his income tax obligations with respect to that item under Section 28(a) of the Revised Organic Act of the Virgin Islands (48 U.S.C. 1642). That section provides that all persons whose permanent residence is in the Virgin Islands "shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the Treasury of the Virgin Islands."

Contrary to the conclusion of the court of appeals, Section 1.1441-4(d) has no application to this case. By its terms, it applies only when the recipient of dividend or interest income from United States sources is a permanent resident of the Virgin Islands and thereby liable for Virgin Islands tax upon his world-wide income. Thus, if a United States-subsidiary distributed a dividend to its Virgin Islands parent, the subsidiary would not be required to withhold the 30 percent United States tax. The parent is subject to Virgin Islands tax on all of its income pursuant to Section 28(a) of the Revised Organic Act of the Virgin Islands. There would accordingly be no reason to withhold United States taxes from such income.

This case presents the converse situation. Here, respondent, a Virgin Islands corporation, distributed a dividend to Chase, its United States parent. By virtue of Sections 1441 and 1442 as applied in the Virgin Islands, respondent was required to withhold the 30 percent Virgin Islands tax upon this dividend income. But since Chase is not a permanent resident of the Virgin Islands under Section 28(a) of the Revised Organic Act, Chase is not eligible for the Regulation's special exemption from the withholding requirements for residents of the Virgin Islands. We therefore agree with the Government of the Virgin Islands that the court of appeals erred in holding that respondent was not required to withhold the 30 percent Virgin Islands tax from its dividend distribution to Chase.

The court of appeals attempted to buttress its conclusion by stating that "if the regulation as well as the underlying statute is mirrored, there can be no withholding on dividend income paid by a Virgin Islands corporation to a United States (foreign) corporation" (Pet. App. A, p. 10a). But there is no basis for "mirroring" the Regulation, the application of which specifically requires that the recipient of the income be a permanent resident of the Virgin Islands subject to a tax of that jurisdiction under Section 28(a) of the Revised Organic Act of the Virgin Islands. Since Chase is not able to satisfy its tax obligations on all of its income to the Virgin Islands as a resident of that jurisdiction under Section 28(a) of the Revised Organic Act, the Regulation does not apply to distributions from its Virgin Islands subsidiary.[1]

[1]*Sayre & Company* v. *Riddell*, *supra*, upon which the court of appeals relied (Pet. App. A, pp. 11a-12a), actually supports the Government of the Virgin Islands. There, the court held that under the mirror provisions of the Guam income tax, Guam could impose the 30 percent tax on interest paid by a Guam sole proprietorship to a United States corporation. The basis of the decision is that under Section 881, a United States corporation is considered to be a foreign corporation for Guam income tax purposes and thereby subject to the 30 percent tax.

In 1972, Congress overruled the result in *Sayre* by adding to Sections 881 and 1442 of the Code a provision that Guamanian corporations were not to be treated as foreign corporations. By application of the mirror provisions, United States corporations would be treated as domestic corporations by Guam and would not be liable for the 30 percent tax. See Act of October 31, 1972, 86 Stat. 1494; H.R. Rep. No. 92-1479, 92d Cong., 2d Sess. 3 (1972).

In the court of appeals' view, the congressional action with respect to Guam demonstrated that "[o]bviously, Congress intended a 'two-way mirroring' " (Pet. App. A, p. 12a) with respect to the territorial income taxation generally and this "two-way mirroring" justified its construction of Treasury Regulations, Section 1.1441-4(d). But unlike the Virgin Islands, where Section 28(a) of the Revised Organic Act permits a permanent resident to pay its entire tax liability to that territory, Congress has never allowed a Guamanian corporation engaged in business in the United States to satisfy its tax liability on such United States-source income by payment to Guam. Hence, there was no basis for the court of appeals' extrapolation of the 1972 legislation with respect to Guam to the tax system of the Virgin Islands.

2. While we agree that the decision below is erroneous and that it will have an adverse impact upon the revenues of the Virgin Islands,[2] we do not believe that the question warrants review by this Court. The technical narrow issue is limited to the Virgin Islands and does not affect the tax administration of any of the other territories. Moreover, the holding of the court of appeals turns upon the

[2]In *St. Croix Hotel* v. *Leroy A. Quinn*, D. V.I., Civ. No. 76/365, decided August 15, 1977, appeal pending, C.A. 3, the district court held on the authority of the decision below that a United States resident receiving income from the Virgin Islands is taxable on that income only in the United States, and not in the Virgin Islands. This decision appears to be fundamentally inconsistent with the taxing structures created by the Congress for the two jurisdictions.

interpretation of a Treasury Regulation, which the Treasury may amplify in order to eliminate any uncertainty concerning its application to cases of this type. Finally, Congress can clarify the statutory basis for the Virgin Islands' right to withhold taxes from payments made by Virgin Islands corporations to foreign corporations.[4]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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STUART A. SMITH,
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MARCH 1978.

[4]As we have pointed out (pp. 6-7, n. 1), Congress has acted in the past to overrule appellate decisions dealing with territorial taxation. See also *Chicago Bridge and Iron Co.* v. *Wheatley*, 430 F. 2d 973 (C.A. 3), certiorari denied, 401 U.S. 910, which held that a United States corporation was a Western Hemisphere Trade Corporation (26 U.S.C. 921) for Virgin Islands tax purposes. This decision was overruled by Section 307 of the Revenue Act of 1971, 85 Stat. 524.

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